Supreme Court, U. S.
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IN THE

Supreme Court of the United States

October Term, 1977

No. 77-1016

UNITED CALIFORNIA BANK and LILLIAN DISNEY TRUYENS, Co-Executors of the Estate of WALTER E. DISNEY,

Petitioners,

vs.

UNITED STATES OF AMERICA,

Respondent.

Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

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Petitioners,

vs.

UNITED STATES OF AMERICA,

Respondent.

Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

Jurisdiction.

The judgment of the United States Court of Appeals for the Ninth Circuit was entered on October 19, 1977, reversing the District Court's judgment dated December 9, 1974, in favor of the petitioners. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

Question Presented.

Whether the Court of Appeals erred in requiring the petitioners to include, in the amount of long-term capital gains subject to the alternative tax under § 1201(b) of the Internal Revenue Code of 1954, the portion of such gains which was owned by a tax-

exempt charitable organization and held by the petitioners in their capacity as co-executors of a decedent's estate.

Statement of the Case.

Petitioners are the co-executors of the estate of Walter E. Disney, who died on December 16, 1966, a resident of the County of Los Angeles, California. By the terms of his will, Mr. Disney left 45% of the residue of his estate to the Disney Foundation, as trustee for both the Disney Foundation and the California Institute of the Arts, both of which entities are charitable organizations, exempt from tax under Internal Revenue Code § 501(c)(3) [26 U.S.C. § 501(c)(3)].[1]

During each of the years 1967 and 1968, the petitioners, as co-executors of Mr. Disney's estate, sold certain securities which were included in the residue of Mr. Disney's estate and realized long-term capital gains on said sale. Pursuant to the terms of Mr. Disney's will, 45% of said net long-term capital gains was permanently set aside to the Disney Foundation, as charitable trustee.

In their Fiduciary Income Tax Returns for the years 1967 and 1968, the petitioners computed the estate's income tax by applying the alternative tax on capital gains provided by Internal Revenue Code § 1201(b).[2] At all times relevant to this case, § 1201(b) prescribed, in effect, a maximum tax of 25% on long-term capital gains, this tax being characterized as an "alternative tax" in the sense that it is utilized as an alternative

[1]See Appendix. All statutory provisions set forth therein appear in the versions which were in effect during the taxable years in question.

[2]See Appendix.

to the "normal" tax provided by § 1202.[3] Since § 1202 permits the taxpayer to deduct from gross income an amount equal to 50% of net long-term capital gains, application of § 1202 results in a tax on long-term capital gains at a rate equal to one-half of the taxpayer's marginal rate. Thus, when the taxpayer's marginal rate exceeds 50%, the effective rate on long-term capital gains resulting under § 1202 will exceed 25% and the taxpayer will, as an alternative, utilize the 25% rate provided by § 1201(b).

At all times relevant to this case, § 501(c)(3) of the Internal Revenue Code exempted from income tax charitable organizations such as the Disney Foundation, and § 642(c)[4] allowed to estates and trusts an unlimited deduction for amounts paid to, or set aside to, such charitable organizations. Under the relevant local law, Calif. Probate Code § 300,[5] the Disney Foundation, as designated beneficiary under Mr. Disney's will, held title to 45% of the residue of Mr. Disney's estate from the time of his death, subject to the possession of the petitioners and the control of the probate court for purposes of estate administration.

Based upon the foregoing statutory provisions, and the policy underlying them, petitioners viewed themselves, with respect to 45% of the estate's residue, merely as conduits for the Disney Foundation, holding possession to property of which a tax-exempt charitable organization was the owner and receiving as such conduits any capital gains which resulted from sales out

[3]See Appendix.

[4]See Appendix.

[5]See Appendix.

of that charitable organization's 45% interest. Accordingly, in computing the alternative tax under § 1201(b) in this case, the petitioners did not include the Disney Foundation's 45% interest in the capital gains in the amount of capital gains subject to the alternative tax. Thus, no tax was paid on the said 45% and the remaining 55% of the capital gains received the benefit of the alternative tax, the same result which would have occurred had the petitioners distributed to the Disney Foundation 45% of the securities which were sold and had said charitable organization itself sold said 45% of the securities.

The respondent, however, disallowed the petitioners' exclusion of the said 45% from the amount to which the alternative tax was applicable, the respondent taking the position that, in the application of the alternative tax in the case of an estate or trust, said tax must be imposed not only on that portion of the gain passing to taxable beneficiaries but also on that portion of the gain which is owned by a tax-exempt charitable beneficiary. As a consequence of respondent's disallowance, the alternative tax was unavailable to the Disney estate and the petitioners were required to pay additional amounts of tax and interest.[6] The petitioners

[6]The additional tax resulting from the application of § 1202 in this case may be demonstrated by a simplified example. Assuming ordinary taxable income of $20,000, capital gains of $500,000, and a governing instrument giving 50% of the estate to charity, the estate would compute the tax under § 1201(b) by computing the "partial" tax on the ordinary income (computed as follows: partial tax, assuming 30% effective rate = $20,000 x 30% =$6,000) and then adding to the "partial" tax the 25% capital gains tax, computed on that 50% portion of the capital gains which was not set aside to charity (capital gains tax = $500,000 x 50% x 25% = $62,500). Thus, the total tax as computed by the estate under § 1201(b) would be $68,500 ($6,000 + $62,500 = $68,500).

Assuming a 60% effective rate under § 1202, the tax under that section would be computed by subtracting from gross income both the 50% capital gains deduction under § 1202 and the charitable set aside deduction under § 642(c), and by then applying the 60% rate to the balance, as follows:

§ 1202 tax = 60% x ($20,000 + $500,000 − $250,000 — $125,000)
§ 1202 tax = 60% x $145,000
§ 1202 tax = $87,000

Since the tax computed under § 1202 would thus exceed the tax computed by the estate under § 1201(b), the estate would utilize § 1201(b) and pay the tax resulting under that section.

Under respondent's theory, however, the capital gains tax under § 1201(b) would be computed on 100% of the capital gains, including that portion owned by and set aside to charity. Thus, respondent would compute the § 1201(b) capital gains tax as follows: $500,000 x 100% x 25% = $125,000. The total tax under respondent's computations would be $127,000 ($2,000 + $125,000 = $127,000). Since this amount exceeds the tax computed under § 1202, the respondent's position would compel the estate to apply § 1202, even though the tax resulting under § 1202 exceeds the tax computed under the estate's application of § 1201(b).

Petitioners herein recognize that the application of § 1202 does, in effect, exempt from tax the amount set aside to charity, as the tax is computed *under that section*. However, this fact merely highlights the anomalous result of respondent's position, which is to deny tax exemption to such amounts when the tax is computed under § 1201(b). Congress can hardly have intended that estates and trusts having charitable beneficiaries be penalized in their utilization of § 1201(b), by comparison to the tax treatment accorded them under § 1202.

paid said additional amounts of tax and interest and filed timely refund claims therefor. Following the respondent's disallowance of said refund claims, the petitioners filed the complaint herein, and, after a trial upon stipulated facts, the District Court rendered judgment in favor of the petitioners. The respondent thereupon filed its appeal, and, following the hearing of said appeal, the Ninth Circuit Court of Appeals reversed the judgment of the District Court and entered judgment for the respondent.

REASONS FOR GRANTING THE WRIT.

The decision of the Ninth Circuit Court of Appeals in this case is in direct conflict with the decision of the Second Circuit Court of Appeals in *Statler Trust v. C.I.R.* (2nd Cir. 1966), 361 F.2d 128, reversing *Ellsworth M. Statler Trust* (1964), 43 Tax Ct. 208. In *Statler,* the Second Circuit held that trustees, who were required by their governing trust instrument to distribute to charities at least 15% of the trust's net income each year, were entitled to exclude the 15% of the trust's net long-term capital gains so distributed from the amount of net long-term capital gains to which the alternative tax provided by § 1201 (b) was applicable. The Second Circuit reasoned "that an estate or trust is in general treated as a conduit through which income passes to the beneficiary". H.R. Rep. No. 1337, 83rd Cong., 2d Sess., p. 61 (3 U.S. Code Cong. & Adm. News (1954), 4017, 4087), partially quoted in *Statler v. C.I.R.* (2nd Cir. 1966), 361 F.2d 128, 131.

The Second Circuit in the *Statler* case recognized that the essence of the conduit principle is to treat the income of the fiduciary "not as the trust's income but as the beneficiary's" and that under that principle "the beneficiary's share of the income is considered his property from the moment of its receipt by the estate." *Freuler v. Helvering* (1934), 291 U.S. 35, 41-42, 54 S.Ct. 308, 78 L.Ed. 634, 640, quoted in *Statler* at 361 F.2d 128, 131. Since a trust which receives income for a charitable beneficiary is merely a "conduit" for that charity, the Second Circuit held that the tax treatment accorded to such income should be the same as though that income had been received

by the charity itself and, in the specific context of § 1201(b), that the amount of capital gains to which the alternative tax is applicable does not include such capital gains as an estate or trust is required to pay or set aside for charitable purposes.

Given the similarity between the facts of the *Statler* case and the facts of this case, it is clear that had this case arisen within the jurisdiction of the Second Circuit, that court would have decided this case in favor of the petitioners. Indeed, to the extent that the facts of this case differ from those of the *Statler* case, this case presents an even stronger situation for the taxpayer. In *Statler,* the governing trust instrument gave the trustees discretion to distribute each year not less than 15% nor more than 30% of the trust's net income for the year among such charitable organizations, and in such amounts, as the trustees determined. Consequently, it could not be said in the *Statler* case that any of the charitable beneficiaries of the trust had a vested right to any amount or portion of the trust's income. In this case, however, the *Disney Foundation,* under the terms of Mr. Disney's will and the relevant California law, held *title* to 45% of the residue of Mr. Disney's estate from the time of Mr. Disney's death, and the petitioners, as co-executors of Mr. Disney's estate, merely had *possession* of the estate residue for purposes of administration. Accordingly, the petitioners in this case were, in a more literal sense than were the trustees in *Statler,* mere conduits for a charitable beneficiary.[7]

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[7]This circumstance further distinguishes the petitioners' situation from that in *Weil v. Commissioner of Internal Revenue* (6th Cir. 1956), 229 F.2d 593, in which an individual taxpayer was

(This footnote is continued on next page)

Notwithstanding the Second Circuit's decision in the *Statler* case, and the fact that the instant case presents an even stronger occasion for the application of the reasoning and decision of the Second Circuit, the Ninth Circuit expressly rejected the Second Circuit's holding in *Statler* (opinion below, at 563 F.2d 400, 402, 406), refusing to apply the conduit principle in the case of charitable beneficiaries of an estate or trust and holding that, even though proceeds received by an estate are derived from the sale of property which was owned by a charitable beneficiary of the estate, such proceeds are not entitled to the same income tax treatment which they would be accorded had the proceeds been received directly by the charity itself. By so holding, the Ninth Circuit sustained the respondent's position that in the application of the alternative tax such tax must be imposed even on that portion of capital gains which is owned by, and set aside to, a tax-exempt charitable beneficiary; and, by expressly rejecting the Second Circuit's decision in *Statler*, the Ninth Circuit's decision has created a square conflict between the Circuits.

The Ninth Circuit's disagreement in this case with the reasoning and conclusion of the Second Circuit in *Statler* was based upon its erroneous conclusion that the conduit principle does not pertain to amounts of income passing to charities and upon its needlessly formalistic reading of Internal Revenue Code § 1201

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not permitted to deduct his charitable contributions (in excess of his ordinary income) from the amount of his capital gains in computing the alternative tax thereon. As the Second Circuit noted in *Statler*, the voluntary nature of the taxpayer's charitable contributions in *Weil* afforded the court in that case no occasion to consider the applicability and effect of the conduit principle. 361 F.2d 128, 131.

(b). While both the respondent and the Court below have recognized the applicability of the conduit principle in the case of taxable beneficiaries of estates and trusts, the Ninth Circuit distinguished the situation of nontaxable charitable beneficiaries on the purported ground that conduit treatment for such beneficiaries does not "emerge boldly from the Code's language." 563 F.2d 400, 404. In so concluding, the Circuit Court not only misconstrued the pertinent provisions of the Internal Revenue Code, but it disregarded the historical foundations of the conduit principle, and the strong Congressional policy underlying that principle, as it applies to charitable beneficiaries.

The applicability of the conduit principle in the context of charitable beneficiaries of estates and trusts has been judicially recognized since almost the earliest enactments of the modern federal income tax law. As early as the Revenue Acts of 1916 and 1918, it was recognized that "the purpose of the statute is to exempt from taxation all income essentially belonging to religious, charitable, scientific or educational corporations," *Slocum v. Bowers* (S.D. N.Y. 1926), 15 F.2d 400, 405, aff'd sub nom. *Bowers v. Slocum* (2nd Cir. 1927), 20 F.2d 350, and that "the expressed intent of the Congress . . . was to tax the income received by the estate which would pass to any person subject to taxation, but relieve from taxation the income set aside by the terms of the will for corporations of [charitable] character . . .". *Bowers v. Slocum* (2nd Cir. 1927), 20 F.2d 350, 352.

The congressional intention to exempt from taxation "all income essentially belonging to" charitable organi-

zations requires that such amounts not be subjected to tax simply because of an executor's failure to distribute such amounts to the charitable organization. *Slocum v. Bowers, supra,* 15 F.2d 400, 405. Yet such additional tax is the inevitable consequence of the Circuit Court's decision in this case. If the petitioners, instead of selling the residuary securities allocable to the Disney Foundation, had distributed those securities to the Foundation, there can be no question but that any gains realized by the Disney Foundation on its own subsequent sale of those securities would have been wholly exempt from tax, while at the same time the gains realized on the remaining 55 percent of the residuary securities would have been eligible for the alternative tax provided by Section 1201(b). The Ninth Circuit's decision in this case causes the amount of the tax to depend squarely upon whether the representative of the estate has exercised his discretion to seek a partial distribution of the estate, a result clearly at variance with long recognized and clearly expressed Congressional intent.

In seeking statutory support for its rejection of the conduit principle in the case of charitable beneficiaries, the Ninth Circuit in this case reasoned that if the conduit principle were applicable to such beneficiaries, Congress would have provided that amounts distributed to or set aside for charities are to be "excluded" from the gross income of the estate or trust rather than simply "deducted" as § 642(c) provides. Such reasoning overlooks the fact that the income of an estate or trust which is distributed to taxable beneficiaries (to whom, as the Ninth Circuit recognizes, the conduit principle does apply) is also not excluded from the gross income of the estate or trust but is

simply deducted, in that case under § 661. The Ninth Circuit in this case seems to have concluded that since amounts distributed to or set aside to charitable beneficiaries are not given conduit treatment identical to that given to taxable beneficiaries, such amounts are not given conduit treatment at all. Such analysis, apparently premised on the Ninth Circuit's assumption that the conduit principle can be expressed through only one statutory scheme, ignores the fact that the statutory provisions governing the taxation of estates and trusts provide very clearly, albeit separately, for the conduit treatment of amounts passing to charitable beneficiaries, creating, in effect, one system of conduit treatment for taxable beneficiaries and a separate system of conduit treatment for charitable beneficiaries.

The system of conduit treatment for charitable beneficiaries, far from being absent in the provisions of the Internal Revenue Code, is in fact a far stronger manifestation of the conduit principle than that system of conduit treatment which is provided for taxable beneficiaries. Sections 661 and 662 provide conduit treatment for taxable beneficiaries by allowing as a deduction to the estate or trust, and requiring to be taken into income by the recipient, only such amounts as are "properly paid or credited or required to be distributed" during the taxable year. Other amounts, properly retained by the estate or trust during the taxable year, are not given conduit treatment but are instead generally taxed to the estate or trust as that entity's taxable income. On the other hand, § 642(c), which implements the conduit principle in the case of charitable beneficiaries, gives the estate or trust an unlimited deduction not only for amounts which are paid for charitable purposes during the taxable

year, but also for amounts which during the taxable year are "permanently set aside" for such purposes. Thus, while the conduit principle as exemplified by § 661 and § 662 operates only at the time of an actual or required distribution from an estate or trust, the conduit principle as manifested in § 642(c) operates from the moment of the estate or trust's receipt of the income item in question where, as in this case, such item is required to be set aside for charitable purposes.

Compounding its rejection in this case of the conduit principle's applicability to charitable beneficiaries, the Ninth Circuit has elected instead to "interpret section 1201(b) . . . precisely as it is written," 563 F.2d 400, 405. The Court below has observed that the language of § 1201(b) does not provide for any deductions from the amount of net long-term capital gains to which the alternative tax is applied. *Id.* However, a construction of § 1201(b) such as to deny the deduction which petitioners seek in this case and which the Second Circuit recognized and allowed in the *Statler* case is needlessly formalistic and harsh. Such construction not only disregards the long established and clearly expressed Congressional policy that conduit treatment is to be accorded amounts passing to charitable beneficiaries of estates and trusts; it also ignores the fact that the supposedly "precise" language of § 1201(b) is flexible enough to permit, in appropriate situations, a deduction from the amount of capital gains to which the alternative tax is applied. The cases of *Meissner v. United States* (Ct. Cl. 1966), 364 F.2d 409; *Read v. United States* (5th Cir. 1963), 320 F.2d 550; and *Estate of Harry B. Sidles* (1976), 65 Tax Ct. 873, demonstrate unequivocally that the language of § 1201

(b) permits a deduction, from the amount of capital gains to which the alternative tax is applied, when the effect of permitting such deduction is to further Congressional intent. In fact, the position of the Internal Revenue Service in the *Sidles* case reflects its acquiescence in this construction. The fact that these cases were concerned with a provision of the Internal Revenue Code[8] not related to those provisions pertaining to the taxation of estates and trusts does not, contrary to the Ninth Circuit's conclusion herein, make those cases "inapposite to the issue before us". 563 F.2d 400, 405. As those cases demonstrate, deductions will be permitted under § 1201(b) where such deductions are in furtherance of Congressional policy. Few Congressional policies are more clearly evidenced in the Internal Revenue Code than the policy to exempt from taxation amounts passing to charitable organizations. It has long been recognized that the statutory provisions reflecting this policy "were begotten from motives of public policy, and are not to be narrowly construed". *Helvering v. Bliss* (1934), 293 U.S. 144, 151, 55 S.Ct. 17, 20, 79 L.Ed. 246, 251. By its unduly narrow construction of § 1201(b), the Court below has also given an unduly narrow construction to the policy of charitable exemption which underlies the Internal Revenue Code.

Conclusion.

Regardless of whether the taxable beneficiaries or the charitable beneficiaries of the estate were to bear the additional tax resulting from the Circuit Court's decision in this case, the inevitable consequence of

[8] § 691(c), pertaining to a deduction which is based on the estate tax imposed on income in respect of decedents.

such tax would be to increase the cost of, and hence to discourage, individual contributions to charity. Such consequence, which would be in derogation of a strong Congressional tax policy favoring charities, can be easily avoided by a proper construction of the statutory provisions pertinent to this case, such as was adopted by the Second Circuit Court of Appeals in *Statler Trust v. C.I.R.* (2nd Cir. 1966), 361 F.2d 128. The Ninth Circuit Court of Appeals, in its decision herein, expressly rejected the reasoning and decision of the Second Circuit in *Statler,* adopting instead an erroneous and undesirable construction of those provisions and creating a clear conflict among the Circuits on an important question of federal law.

For all of the reasons stated herein, the petitioners respectfully request that this Court grant their petition for a writ of certiorari.

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APPENDIX.

26 U.S.C. § 501.

(a) *Exemption from taxation.*—An organization described in subsection (c) or (d) or section 401(a) shall be exempt from taxation under this subtitle unless such exemption is denied under section 502, 503, or 504.

* * *

(c) *List of exempt organizations.*—The following organizations are referred to in subsection (a):

* * *

(3) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office. (All statutory provisions set forth herein appear in the respective versions of such provisions which were in effect during the taxable years in question.)

26 U.S.C. § 1201.

* * *

(b) *Other taxpayers.*—If for any taxable year the net long-term capital gain of any taxpayer (other than a corporation) exceeds the net short-term capital loss, then, in lieu of the tax imposed by sections 1 and 511, there is hereby imposed a tax (if such tax is

less than the tax imposed by such sections) which shall consist of the sum of—

(1) a partial tax computed on the taxable income reduced by an amount equal to 50 percent of such excess, at the rate and in the manner as if this subsection had not been enacted, and

(2) an amount equal to 25 percent of the excess of the net long-term capital gain over the net short-term capital loss.

26 U.S.C. § 1202.

In the case of a taxpayer other than a corporation, if for any taxable year the net long-term capital gain exceeds the net short-term capital loss, 50 percent of the amount of such excess shall be a deduction from gross income. In the case of an estate or trust, the deduction shall be computed by excluding the portion (if any), of the gains for the taxable year from sales or exchanges of capital assets, which, under sections 652 and 662 (relating to inclusions of amounts in gross income of beneficiaries of trusts), is includible by the income beneficiaries as gain derived from the sale or exchange of capital assets.

26 U.S.C. § 642.

* * *

(c) *Deduction for amounts paid or permanently set aside for a charitable purpose.*—In the case of an estate or trust (other than a trust meeting the specifications of subpart B) there shall be allowed as a deduction in computing its taxable income (in lieu of the deductions allowed by section 170(a), relating to deduction for charitable, etc., contributions and gifts) any amount of the gross income, without limitation, which pursuant to the terms of the governing instrument is, during the taxable year, paid or permanently set aside for a purpose specified in section 170(c), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance or operation of a public cemetery not operated for profit. For this purpose, to the extent that such amount consists of gain from the sale or exchange of capital assets held for more than 6 months, proper adjustment of the deduction otherwise allowable under this subsection shall be made for any deduction allowable to the estate or trust under section 1202 (relating to deduction for excess of capital gains over capital losses). In the case of a trust, the deduction allowed by this subsection shall be subject to section 681 (relating to unrelated business income and prohibited transactions).

California Probate Code, § 300.

§300. *Estates All Subject to Court Administration—Exceptions*

When a person dies, the title to his property, real and personal, passes to the person to whom it is devised or bequeathed by his last will, or, in the absence of such disposition, to the persons who succeed to his estate as provided in Division II of this code; but all of his property shall be subject to the possession of the executor or administrator and to the control of the superior court for the purposes of administration, sale or other disposition under the provisions of Division III of this code, and shall be chargeable with the expenses of administering his estate, and the payment of his debts and the allowance to the family, except as otherwise provided in this code.

Opinion.

[563 F.2d 400]

UNITED CALIFORNIA BANK and Lillian Disney Truyens, Co-Executors of the Estates of Walter E. Disney, Plaintiffs-Appellees, v. UNITED STATES of America, Defendant-Appellant

No. 75-1616.

United States Court of Appeals, Ninth Circuit.

Oct. 19, 1977.

A decedent's estate instituted a suit for refund of certain taxes. The United States District Court for the Central District of California, Irving Hill, J., held in favor of the taxpayer, and the United States appealed. The Court of Appeals, Sneed, Circuit Judge, held that that portion of the estate's net long-term capital gain which was required to be set aside permanently for a charitable organization could not be deducted from the net long-term capital gain in calculating the alternative tax on capital gains when to do so was advantageous to the taxpayer.

Reversed.

[563 F.2d 401]

Mason C. Lewis, Asst. U. S. Atty., Los Angeles, Cal., Dennis M. Donohue, argued, Appellate Section, Tax Division, Washington, D. C., for defendant-appellant.

Marc R. Isaacson, argued, Los Angeles, Cal., for plaintiffs-appellees.

Appeal from the United States District Court for the Central District of California.

Before WALLACE, SNEED and KENNEDY, Circuit Judges.

SNEED, Circuit Judge:

The estate of Walter E. Disney (taxpayer) instituted a suit in district court for the refund of certain taxes assessed against it for the years 1967 and 1968. The district court held in favor of the taxpayer, and the United States appeals therefrom. We reverse.

I.
FACTS.

The parties stipulated to the following facts. Disney, by his will, left 45% of the residue of his estate to certain charitable organizations. During 1967 and 1968, appellees, United California Bank and Lillian Disney Truyens, co-executors of the estate, sold certain securities included in the residue of the estate, on which sales net long-term capital gains of $500,622.38 and $1,058,018.43 were realized in 1967 and 1968 respectively. In 1967, a net short-term capital gain of $16,944.16 also was realized. Pursuant to the terms of the will, appellees set aside 45% of these net long-term capital gains to the charitable organizations.

Appellees computed the taxpayer's income tax for the years 1967 and 1968 under the alternative tax described in I.R.C. § 1201(b).[1] In computing the

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[1]The version of Section 1201(b) in effect at that time provides:

> Other taxpayers.—If for any taxable year the net long-term capital gain of any taxpayer (other than a corporation) exceeds the net short-term capital loss, then, in lieu of the tax imposed by sections 1 and 511, there is hereby imposed a tax (if such tax is less than the tax imposed by such sections) which shall consist of the sum of—
>
> (1) a partial tax computed on the taxable income reduced by an amount equal to 50 percent of such excess, at

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tax, appellees deducted the 45% of the net long-term capital gain which had been permanently set aside for charitable purposes from the total net long-term capital gain, which is taxed at a flat rate of 25%.

Appellant United States, through the District Director of Internal Revenue, Los Angeles, California, disallowed this deduction. Without the deduction, the alternative tax was higher than the normal tax, so appellant computed the taxpayer's tax under the normal method and assessed deficiencies in the amounts of $4,998.93 for 1967 and $27,445.05 for 1968, plus interest of $1,099.76 and $4,386.41 for the respective years. Appellees paid these deficiencies and filed their complaint for a refund.

II.
THE CONTROVERSY.

While there are several ways in which the issue before us can be framed our formulation is whether that portion of the net long-term capital gain which is required to be set aside permanently for a charitable organization can be deducted from the net long-term capital gain in calculating the alternative tax under section 1201(b) when to do so is advantageous to the taxpayer. [563 F.2d 402] The district court, relying on the Second Circuit decision in *Statler Trust v. Commissioner of Internal Revenue*, 361 F.2d 128 (2d Cir. 1966), held in the affirmative. The Government, although recognizing that *Statler Trust* is on point, contends that *Statler Trust* was wrongly decided. We agree with the Government.

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the rate and in the manner as if this subsection had not been enacted, and
(2) an amount equal to 25 percent of the excess of the net long-term capital gain over the net short-term capital loss.

The conflict between the Government and the taxpayer can be understood better if we set forth calculations derived from a hypothetical situation which reflect the competing views. Assume an estate in which in the taxable year 1967 one-half of the net long-term capital gains by the terms of the governing instrument is permanently set aside for charity. Assume further that in 1967 the estate realized and recognized $50,000 consisting of net long-term capital gains. Both the taxpayer estate and the Government agree that the taxable income of this hypothetical trust would amount to $175,000 calculated in the following manner:

Gross Income		$550,000
Less: Sec. 1202 deduction[2]	$250,000	
Sec. 642(c) deduction[3]	$125,000	
Total Deductions	$375,000	
Estate Taxable Income		$175,000

Assuming an effective rate of 60% the normal tax would amount to $105,000.

In computing the alternative tax the Government proceeds as follows:

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[2]I.R.C. § 1202 authorizes a deduction by a taxpayer other than a corporation of 50 percent of the excess net long-term capital gain over net short-term capital loss in computing taxable income.

[3]I.R.C. § 642(c). The operation of this section requires a bit of explaining. It authorizes a deduction by an estate or trust for "any amount of gross income, without limitation, which pursuant to the terms of the governing instrument is, during the taxable year, permanently set aside" for charity. This suggests the deduction should be $250,000; however, this would permit a charitable deduction *and* a section 1202 deduction which would eliminate the entire amount of net long-term capital gain from taxable income although only one-half of it was permanently set aside for charity. This result is foreclosed by the provision in section 642(c) which requires that "proper adjustment of the deduction otherwise allowable . . . shall be made for any deduction allowable to the estate or trust under section 1202 . . ." Treas.Reg. § 1.642(c)-3 (1960). *See* M. C. Ferguson, J. Freeland, & R. Stephens,

(This footnote is continued on next page)

Estate Taxable Income	$175,000
Less: 50% of excess net long-term capital gain over net short-term capital loss.[4]	$250,000
Partial Taxable Income	—0—
Partial Tax	—0—
Tax on Excess of Net Long-Term Capital Gain Over Net Short-Term Capital Loss (25% of $500,000)	$125,000

Inasmuch as the alternative tax so computed is greater than the normal tax of $105,000, the latter is the proper tax as the Government sees it.

[563 F.2d 403]

The taxpayer, troubled by the "wastage" of the excess ($75,000) of the $250,000 deduction over the estate's taxable income of $175,000, computes the alternative tax in a manner that eliminates the "wastage." Its method is as follows:

Estate Taxable Income	$175,000
Less: 50% of that portion of the excess of net long-term capital gain over net short-term capital loss *not permanently set aside for charity*. ($250,000)	$125,000
Partial Taxable Income	$ 50,000
Partial Tax (assume 60% effective rate)	$ 30,000
Tax on Excess of Net Long-Term Capital Gain Over Net Short-Term Capital Loss *Not Permanently Set Aside For Charity*. (25% of $250,000)	$ 62,500
Total Alternative Tax	$ 92,500

By eliminating the "wastage" the alternative tax is less than the normal tax and thus is the amount owed by the taxpayer estate. The actual figures involved

Federal Income Taxation of Estates and Beneficiaries 372-73 (1970). That portion of the gain set aside for charity ($250,000) is reduced by that portion of it ($125,000 or one-half of the total) already deducted by reason of section 1202. The balance, $125,000, constitutes the section 642(c) deduction.

[4]I.R.C. § 1201(b)(1).

in this case are different, although within the same range of magnitude of those above.[5]

III.
THE RELEVANT STRUCTURE OF THE CODE.

The Code could be drafted in a manner that would conform to the taxpayer's [563 F.2d 404] wishes. Unfortunately, it is not so written. To conform to the taxpayer's understanding the applicable provisions of the code should reflect a consistent pattern of treating sums distributed to, or permanently set aside for, char-

[5]For example, using the rounded-off figures for 1967, the competing methods show the following calculations.

Normal Tax		
Gross Income		$595,000
Less: § 1202 deduction	$250,000	
§ 642(c) deduction	$145,000	
Other deductions	$ 54,000	
	$449,000	
Estate Taxable Income		$146,000
Tax (regular rates)		$ 88,000
Alternative Tax		
(1) Taxpayer's Method.		
Estate Taxable Income		$146,000
Less: 50% of that portion of the excess of net long-term capital gain over net short-term capital loss not permanently set aside for charity		$137,500
Partial Taxable Income		$ 8,500
Tax (normal rates)		$ 1,800
Tax on Excess of Net Long-Term Capital Gain Over Net Short-Term Capital Loss Not Permanently Set Aside For Charity (25% of $275,000)		$ 69,000
Total Alternative Tax		$ 70,800
(2) Government's Method.		
Estate Taxable Income		$146,000
Less: 50% of excess of net long-term capital gain over net short-term capital loss		$250,000
Partial Taxable Income		—0—
Tax on Excess of Net Long-Term Capital Gain Over Net Short-Term Capital Loss (25% of $500,000)		$125,000
Total Alternative Tax		$125,000

ity as amounts substantially insulated from other transactions affecting the taxable status of the estate or trust or its beneficiaries occurring during the relevant taxable period. In short, "conduit" treatment of such sums should emerge boldly from the Code's language. It does not.

To begin with, "conduit" treatment would suggest that amounts distributed or set aside for charity would be *excluded* from the distributable net income of the estate or trust as described in section 643 and, in determining the amount includible in the gross income of an estate or trust beneficiary, section 662 would allocate only an amount reduced by such distributions or set asides. Correspondingly, no portion of such distribution or set asides directly would be allocable to items distributable to non-charitable beneficiaries. Finally, there would be no *deduction* for amounts paid or permanently set aside for charity in computing the taxable income of the estate or trust; such amounts would simply be *excluded* from the gross income of the estate or trust.

The present Code proceeds differently. Amounts distributed or set aside to charity are not excluded from the computation of distributable net income pursuant to section 643. Even when such amounts consist of capital gains they remain in distributable net income. I.R.C. § 643(a)(3). Amounts includible in the income of non-charitable estate or trust beneficiaries are limited to distributable net income which is arrived at after allowance of an unlimited *deduction* for charitable distributions or set asides. I.R.C. § 662(a), § 642(c). This deduction is "allocated among the items of distributable net income" (I.R.C. § 662(b) 3rd sentence) which items, in the hands of non-charitable distributees,

retain the same character they had in the hands of the estate or trust. I.R.C. § 662(b); Treas.Reg. § 1.662(b)-2 (1960).

More directly to the point of this case, a "conduit" approach with respect to charitable distributions and set asides would involve a different method of calculating the normal tax than that which both the taxpayer and government agree is proper. To illustrate, return to the foregoing example. A "conduit" approach would result in the following normal tax computation:

Gross Income as Adjusted (Receipts of $550,000 Reduced by Amount Set Aside to Charity $250,000)	$300,000
Less: Section 1202 deduction (50% of that portion of the excess of net long-term capital gain over net short-term capital loss *not permanently set aside for charity.*)	$125,000
Estate Taxable Income	$175,000[6]

Assuming an effective rate of 60%, the normal tax is the same as under the proper computation method. The difference, however, is that it is clear that section 1202 and [563 F.2d 405] 642(c) do not countenance a "conduit" approach in calculating the normal tax. To the extent that further proof of the Code's rejection of this approach in the present context

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[6]Even if the set aside or distribution to charity remains in the gross income of the estate a computation method more in keeping with the taxpayer's would be as follows:

Gross Income		$550,000
Less: Amount Set Aside to Charity	$250,000	
Section 1202 Deduction	$125,000	
Total Deduction		$375,000
Estate Taxable Income		$175,000

Neither method of computing the normal tax is employed. The proper method is that set forth on p. 2391, *supra*.

is required, it is supplied by the second sentence of section 1202.[7] This sentence *permits* the exclusion of capital gains which under sections 652 and 662 are includible in the gross income of income beneficiaries of estates or trusts as gain derived from the sale or exchange of capital assets. No mention is made of excluding capital gains distributed to or set aside for charity. Consistent application of the conduit approach would require such a provision.

Confronted with these numerous inconsistencies between the taxpayer's conduit theory and the structural characteristics of the applicable portions of the Code we believe the proper course is to follow closely the Code's precise language. Being so guided we are less likely to disturb a carefully constructed balance among intricately designed sections which to us may be in part both unseen and unknown. Being so guided we interpret section 1201(b), which describes the method by which the alternative tax is to be computed, precisely as it is written.[8] The excess of the net long-term capital gain over the net short-term capital loss for the purpose of this section is required to be computed without reduction for any amount distributed to or set aside for charity. No such reduction is authorized any more than is a similar reduction under section 1202.

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[7]This sentence reads:

> In the case of an estate or trust, the deduction shall be computed by excluding the portion (if any), of the gains for the taxable year from sales or exchanges of capital assets, which, under sections 652 and 662 (relating to inclusions of amounts in gross income of beneficiaries of trusts), is includible by the income beneficiaries as gain derived from the sale or exchange of capital assets.

[8]Footnote 1, *supra*. *See Weil v. Commissioner of Internal Revenue*, 229 F.2d 593 (6th Cir. 1956).

IV.

THE RELEVANT AUTHORITIES.

Taxpayer, in addition to *Statler Trust*, relies heavily on cases which have permitted the deduction under section 691(c) for estate taxes properly allocable to income in respect of a decedent against long-term capital gains in computing the alternative tax. *Meissner v. United States*, 364 F.2d 409, 176 Ct.Cl. 684 (1966); *Read v. United States*, 320 F.2d 550 (5th Cir. 1963); *Sidles v. Commissioner of Internal Revenue*, 65 T.C. 873 (1976)[9] We express no opinion with respect to the correctness of these decisions. They are, in any event, inapposite to the issue before us.

It is true, of course, that these decisions adopt an approach that precludes the "wastage" of section 691(c) deductions in computing the alternative tax on capital gains and that the taxpayer here also seeks to avoid the "wastage" of a deduction in the same computation. The similarity between *Meissner*, *Read*, and *Sidles* and this case ends at that point, however. The charitable contribution deduction in Subchapter J dealing with the taxation of estates and trusts is carefully integrated into a very complex statutory pattern which, as already indicated, reflects a design inconsistent with the philosophy of the taxpayer's case. No such intricate fashioning appears with respect to the section 691(c) deduction. This section merely provides for a deduction for estate tax attributable to amounts regarded as income in respect of a decedent. It does not specify the manner in which the deduction

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[9]*See also Quick v. United States*, 503 F.2d 100 (10th Cir. 1974); *Goodwin v. United States*, 458 F.2d 108, 198 Ct.Cl. 88 (1972).

is to be utilized. Moreover, the avoidance of complete double taxation under the estate and income tax of items of income in respect of a decedent, which is the purpose of the section 691(c) deduction, provides a forceful reason for permitting the utilization of the deduction in computing the alternative tax.

[563 F.2d 406]

This reason is not applicable in the case before us. In holding as we do we do not subject capital gains to double taxation nor do we eliminate the effectiveness of the charitable contribution deduction for estates and trusts. While we do preclude the reduction of the flat tax on capital gains in calculating the alternative tax by refusing to permit the capital gains to be reduced by amounts paid or permanently set aside to charity, we do so in accordance with both the letter and the spirit of the applicable provisions of the Code. In this respect we cannot improve on the words of Judge Dooling who, in his dissent in *Statler Trust*, said, "The statute's effect is too plain to be supposed an inadvertent one, and it is far from being ungenerous. The alternatives are payment of the tax at ordinary rates on half the capital gain less the adjusted deduction for the part of it paid to charity or paying a tax on that same income amount equal to a quarter of the total capital gain." 361 F.2d at 133.[10] Essentially the same approach was taken in

[10]The present section 1201 imposes a heavier burden on the taxpayer than that described by Judge Dooling. I.R.C. § 1201(b). His point remains valid, however. The extent of the burden is prescribed by Congress; it should not be reduced by means not described by Congress. Its increasing complexity and specificity set it apart from the section 691(c) deduction.

Weil v. Commissioner of Internal Revenue, 229 F.2d 593 (6th Cir. 1956).

We, therefore, do not agree with the court in *Statler Trust* where, speaking through Judge Friendly, it characterized the Government's interpretation as both "unfair" and "unintended." *Id.* at 131. It is, in fact, neither. The court's reliance on section 643(a)(3)'s inclusion of charitable payments and set asides from capital gains in distributable net income to evidence a pervasive reliance on a conduit principle for such charitable provisions is misplaced. Section 643(a)(3), as already indicated, is part of a structure which in its entirety unmistakably rejects the conduit principle for charitable payments and set asides. Its specific purpose is to retain capital gains so paid or set aside in distributable net income so as to permit the allocation of the benefits of the deduction among items of distributable net income in accordance with section 662(b) and the regulations thereunder. Treas.Reg. § 1.643(a)-5(b) (1960); § 1.662(b)-2 (1960).

We are aware, of course, that any computation that reduces taxes on taxable beneficiaries because of charitable payments or set asides is directly advantageous to such beneficiaries and indirectly helpful to charities generally. While such a consideration in an exquisitely balanced situation might be controlling, the case before us is not such a situation. To permit such concerns to control here is contrary to the statute as written.

We therefore reverse and direct that the taxes for the years 1967 and 1968 be computed as the Government insists. The refunds sought are denied.

REVERSED.

Service of the within and receipt of a copy thereof is hereby admitted this ..... day of January, A.D. 1978.

Supreme Court, U. S.
FILED
MAY 18 1978
MICHAEL RODAK, JR., CLERK

APPENDIX.

IN THE

Supreme Court of the United States

October Term, 1977
No. 77-1016

UNITED CALIFORNIA BANK and LILLIAN DISNEY TRUYENS, Co-Executors of the Estate of WALTER E. DISNEY,

Petitioners,

vs.

UNITED STATES OF AMERICA,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

Petition for Certiorari Filed January 17, 1978.
Certiorari Granted March 20, 1978.

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IN THE

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UNITED CALIFORNIA BANK and LILLIAN DISNEY TRUYENS, Co-Executors of the Estate of WALTER E. DISNEY,

Petitioners,

vs.

UNITED STATES OF AMERICA,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

APPENDIX.

Civil Docket
United States District Court
[Title of Court and Cause]

Date	Proceedings
12/5/73	Fld Complt. Issd summs. Md JS-5. (eam.)
1-2-74	Fld letter from Mr. Kritzman, Clerk re: receiving letter from firm of Gibson, Dunn & Crutcher & U.S. Attny that they have indicated no obj to continuing case. (mn)
1-11-74	Fld retn of summs. Served. (mn)
2/5/74	Fld Stip and ORDER ext'g time [illegible]ft to ans or otherwise plead to 2/8/74. (jcd)
	Fld Crt's Notc as to no fur extensions or continuance to 4/9/74. (jcd)

Date	Proceedings
4-11-74	Fld deft's ANSWER to complt. (dz)
4/15/74	Fld Crt's Notc of PTC and ORD re un served ptys, set for 6/17/74 at 10:00 A.M. (jcd)
5/8/74	MIN ORD: It is Ord that the Status Conf heretofore set for 5/16/74 is hereby vacated. Mld cpys to cnsl. (jcd)
6/10/74	Fld ltr dtd 6/10/74 in form of ord settg matter on for status conf 6/17/74, 10 a.m. (jcd)
6/28/74	Fld pltfs' stip of facts and question of law (jcd)
7/9/74	Fld deft Supplemental Stip of facts. (jcd)
7/17/74	Fld Stip and ORD cont'g of briefing schedule —pltfs' opening brief from 7/19/74 to be fld on or bef 8/2/74; deft's reply brief from 8/9/74 to be fld on or bef 8/23/74 and pltfs' reply brief from 8/30/74 to be fld on or bef 9/13/74. (jcd)
8-2-74	Fld pltfs Trial memo. (mn)
8-27-74	Fld Stip & ORD ext ti for deft to fl response brief to 9-6-74 & ext ti for pltf to fl reply brief to 9-27-74. (cb)
9-6-74	Fld defts brief in response to pltfs trial memo. (cb)
9-27-74	Fld pltf's reply brief. (cb)
10/25/74	MIN ORD: Ort Ord oral arguments cont to 11/7/74, 3pm. Cnsl notified. (sam)
11/7/74	MIN ORD: C/T. Crt finds Judgmt in favor of pltfs. Pltfs cnsl ord to prepare Judgmt & findings of fact to be lodged with the Crt by 11/15/74 & any opposing response in writing by 11/20/74.

Date	Proceedings
11/22/74	LODGED pltf's proposed finding of facts & conclusions of law (jk)
12/2/74	Fld findings of fact & conclusions of law; Fld Jdgmt that United Calif. Bank & Lillian Disney Truyens Co-Executors of Wstate of Walter Disney hv jdgmt agnst the United States of America in the am of $85,795.20. plus $10.488 for ea day fr Nov. 22 1974 to the date of entry of Jdgmt. w/interest to accrue on the am of jdgmt fr & after the date of entry of jdgmt, at rates & for the periods prescribed by law (JS-6 (12/9/74) mld & ntfd prtys (SEE PAGE 3)
2-6-75	Fld USA NOTICE OF APPEAL of Judgment entered on 12-9-75. w/Proof of Service. (mn)
2/13/75	Fld USA design of record on appeal (jk)
3/4/75	Fld orig and cy of rptr's transcrpt of prcdgs had on 11/7/74 Issd and fwd to C/A orig rec on appeal along with orig and cy of rptr's transcrpt of prcdgs had on 11/7/74.
12/7/77	MIN ORD: The Crt having received a judgment from the C/A reversing this Crt's judgment. It is ORD that the judgment be filed and spread. Filed judgment from C/A reversing this rt's judgment. (ENT 12/9/77). (tm)
1/3/78	LODGED: deft's proposed judgment.
1/10/78	Fld jdgmt & ORD thereon that pltf tk nthng, dsmg complt & that deft revr costs. (Ent 1/11/78) (rlb)
1/13/78	Fld ltr dtd 12/8/77 frm Judge Hill to cnsl re mandate frm C/A. (rlb)

United States Court of Appeals for the Ninth Circuit

Date	Filings-Proceedings

1975

March 17 DOCKETED CAUSE AND ENTERED APPEARANCES OF COUNSEL -acb- (USA)

Mar. 17 FILED CERT TRANSC RECORD ON APPEAL IN TWO VOLUMES: VOL. I, PLEADINGS, ORIG. ONLY, VOL. II, REPORTERS TRANSC., ORIG. & ONE CERT COPY.
Appellant's brief due to be filed on April 29, 1975. -acb-

April 9 FILED TWO ADDITIONAL COPIES OF THE RECORD, VOL. I, PLDGS. -abc-

Apr 28 Filed aplt's motion for ext of time for filing brief. To "C" -ec-

Apr. 30 Filed order (C) extding time to May 29 in which to file applt brief.

May 30 Filed 25 Appellant's briefs 5-29-75 (sj)

July 1 Filed 25 Appellees' briefs (6/30/75) -dmf-

July 21 Filed 25 Aplts Reply Briefs (7/17/75) -dmf-

1977

May 23 Rec'd from aples letter dtd. May 20, 1977, re add'l citations. penal

JUNE 1 ARGUED & SUBMITTED TO (WALLACE, SNEED, KENNEDY, CJJ). ty

Oct 21 As of Oct. 19, ORDERED OPINION *(SNEED)* FILED & JUDG TO BE FILED & ENTD

Oct 21 As of Oct. 19, Filed opinion—We reverse and direct that the taxes for 1967 and 1968

Date	Filings-Proceedings

be computed as the Government insists. The refunds sought are denied. REVERSED.

Oct 21 As of Oct. 19, Filed & Entd Judgment. -fn-

Nov 2 Filed aplt's (USA) Bill of Costs. 10-31 ec

Nov 9 1977 MANDATE ISSUED

Dec. 5 Returned ORIGINAL PLDGS, VOL. 1, and R.T.s, VOL. 2, and 1 copy to CLERK, DIST. CT. cf

1978

JAN 23 Recd SC notice of filing on 1/17/78 petition for certiorari, assigned SC # 77-1016. Th.

Mar 24 Filed cert. SC order of 3/20/78 granting pet. of certiorari. (Copy to panel) Th.

Stipulation of Facts and Question of Law.

United States District Court, for the Central District of California.

UNITED CALIFORNIA BANK and LILLIAN DISNEY TRUYENS, Co-Executors of the Estate of Walter E. Disney, Plaintiffs, vs. UNITED STATES OF AMERICA, Defendant. NO. 73 2828 IH.

FILED: Jun 28, 1974.

Pursuant to their prior agreement in open court, the attorneys for Plaintiffs and Defendant hereby stipulate that the within case shall be tried on the set of facts set forth hereinbelow as "Stipulated Facts" and that the question of law on which the within case is to be decided is as set forth hereinbelow as "Question of Law."

STIPULATED FACTS

1. Walter E. Disney died on December 16, 1966. His Will was admitted to probate in the Superior Court of the State of California for the County of Los Angeles on January 6, 1967. (A copy of said Will of Walter E. Disney is attached hereto as Exhibit A.) Plaintiffs were appointed as Co-Executors of the Estate.

2. By his Will Walter E. Disney left 45 percent of the residue of the Estate to the Disney Foundation ("Foundation"), in trust for the Foundation and for the California Institute of the Arts ("Institute"). At all times relevant hereto, both the Foundation and the Institute, and the said trust created by the Will under which the Foundation is Trustee, have been charitable organizations organized and operated exclusively for charitable, scientific, and/or educational purposes within the meaning of Section 501(c)(3) and Section 170(c)(2) of the Internal Revenue Code of 1954 ("Internal Revenue Code"). Such organizations

are exempt from Federal income tax under Section 501 of the Internal Revenue Code and contributions to such organizations are deductible under Section 170 of the Internal Revenue Code.

3. Pursuant to the terms of the Will of Walter E. Disney, throughout the years 1967 and 1968 the Plaintiffs, as Co-Executors of the Estate, set aside 45 percent of the residue of the Estate for the benefit of the Foundation as Trustee for the Foundation and the Institute.

4. During each of the years 1967 and 1968, Plaintiffs, as Co-Executors of the Estate and pursuant to orders issued by the Superior Court of the County of Los Angeles, sold certain securities included in the residue of the Estate, on which sales a net long term capital gain in the amount of $500,622.38 was realized in 1967 and a net long term capital gain in the amount of $1,058,018.43 was realized in 1968. No net short term capital losses were incurred by the Estate during such years. In 1967 the Estate realized a net short term capital gain of $16,944.16.

5. Pursuant to the terms of the Will of Walter E. Disney, Plaintiffs as Co-Executors of the Estate set aside 45 percent of the aforesaid net long term capital gains, as a part of the residue of the Estate, to the Foundation, as Trustee for the Foundation and for the Institute.

6. In the Fiduciary Income Tax Returns for the Estate for the years 1967 and 1968, Plaintiffs computed the Estate's income tax by using the alternative tax permitted by Section 1201 of the Internal Revenue Code. (Copies of said Fiduciary Income Tax Returns for the Estate for the years 1967, as amended, and 1968 are attached hereto as Exhibits B and C, respectively.)

7. In computing the aforesaid alternative tax for each of the years 1967 and 1968, Plaintiffs excluded from the amount to which said tax was applicable the 45 percent of net long term capital gains required by the Will, as a part of the residue of the Estate, to be permanently set aside to the Foundation, as Trustee.

8. Defendant, through its agent, the District Director of Internal Revenue, Los Angeles, California, disallowed the exclusion of the amounts of net long term capital gain permanently set aside, as a part of the residue of the Estate, to the Foundation, as Trustee, from the amounts to which the alternative tax was applied. Defendant, through its agent, the District Director of Internal Revenue, Los Angeles, California, allowed Plaintiffs to deduct said amounts of net long term capital gain permanently set aside, as a part of the residue, to the Foundation, as Trustee, in the computation of taxable income under Section 642(c) of the Internal Revenue Code. Said amounts so allowed were $144,738.96 in 1967 and $352,335.01 in 1968. As a result, the Estate incurred additional Federal income taxes of $4,998.93 for the year 1967 and $27,445.05 for the year 1968, plus interest of $1,099.76 and $4,386.41 for the respective years.

9. The aforesaid taxes and interest assessed with respect to the year 1967 were paid to Defendant on March 7, 1972, and the aforesaid taxes and interest assessed with respect to the year 1968 were paid to Defendant on March 21, 1972.

10. With respect to the aforesaid taxes and interest, paid on March 7, 1972 and March 21, 1972, Plaintiffs filed claims for refund, both dated January 2, 1973, by duly and timely mailing said claims for refund to: District Director of Internal Revenue, Federal Building, Los Angeles, California 90012.

11. Defendant has not refunded any part of the amounts claimed by Plaintiffs, but rather has disallowed the claims by letters of July 31, 1973 and January 16, 1974.

QUESTION OF LAW

May the Plaintiffs, as Co-Executors of the Estate of Walter E. Disney, in computing the alternative tax allowed by Section 1201(b) of the Internal Revenue Code on net long term capital gains realized on sales made by the Estate, exclude from such net long term capital gains the 45 percent thereof which, pursuant to the Will, as a part of the residue of the Estate, was required to be permanently set aside for the use and benefit of a charitable trust for a purpose specified in Section 170(c) of the Internal Revenue Code?

DATED: June 28, 1974.

GIBSON, DUNN & CRUTCHER
RONALD E. GOTHER
MARC R. ISAACSON
By /s/ Marc R. Isaacson
Marc R. Isaacson
Attorneys for Plaintiffs

DATED: June 28, 1974.

WILLIAM D. KELLER
United States Attorney
CHARLES H. MAGNUSON
Assistant United States Attorney
Chief Tax Division
MASON C. LEWIS
Assistant United States Attorney
By /s/Mason C. Lewis
Attorneys for the United States of America

EXHIBIT A.

Last Will and Testament of Walter E. Disney

I, WALTER E. DISNEY, a resident of Los Angeles County, California, declare this to be my Last Will and revoke all former Wills and Codicils.

FIRST: I declare that I am married to LILLIAN B. DISNEY and that I have only two children, namely, DIANE DISNEY MILLER and SHARON DISNEY BROWN.

SECOND: It is my intention to dispose by this Will of my one-half (½) of the community property of my wife and myself and of all my separate property, if any. I do not undertake to dispose of my wife's one-half (½) of our community property.

THIRD: In the event that there shall be included in my estate any interest in any residential real properties (*i.e.*, properties occupied by my wife and myself as our residence at the date of my death or as one of several of our residences) I hereby grant to my wife, LILLIAN B. DISNEY, if she survives me, an option to purchase any one or more of such residential real properties. The purchase price for the residential real property purchased shall be its appraised value as shown in the Inventory and Appraisement for my estate, less the amount of any encumbrance on such residential real property. If my wife exercises this option to purchase she shall take such residential real property subject to any encumbrance existing against it at the date of my death and my estate shall not pay any such encumbrance. The purchase price for the residential real property purchased by my wife pursuant to

the exercise of this option may be payable by her either in cash or in stock of Walt Disney Productions (or any successor corporation) at her option. In the event that my wife elects to pay for such residential real property in stock, the value of such stock for such purpose shall be the closing price for the stock on the New York Stock Exchange on the day preceding the day on which my wife obtains title to my interest in such residence pursuant to the provisions of this Article. The option granted hereunder must be exercised by my wife within six months of the date of my death. Any residential real property which is not purchased by my wife pursuant to the provisions of this Article shall augment the residue of my estate provided for under the terms of Article SIXTH below. In the event that any such residential real property is so purchased, the proceeds from the sale shall also augment the residue of my estate and be disposed of as provided in Article SIXTH below.

FOURTH: I give and bequeath to my wife, LILLIAN B. DISNEY, if she survives me by sixty (60) days, all of my tangible personal property and personal effects, including without limitation, all my household furniture, furishings, silverware, books, paintings, works of art, automobiles, clothing, jewelry, miniatures, awards and all other similar items including all policies of insurance on such property. In the event that my wife does not so survive me I give and bequeath all of the property disposed of by this Article FOURTH in equal shares to my children if they both so survive me, or all to the survivor if only one of my children survive me. In the event that my wife and my children do not so survive me, the gift provided for in this

Article FOURTH shall lapse and the properties disposed of under this Article FOURTH shall augment the residue of my estate.

FIFTH: I give, devise and bequeath the rest and residue of my property, real and personal, wherever located, including all failed and lapsed gifts, as follows:

1. Forty-five percent (45%) of such residue shall be distributed to LILLIAN B. DISNEY, HERBERT F. STURDY and UNITED CALIFORNIA BANK as Trustees, IN TRUST. Such Trust shall be known as the Disney Family Trust and shall be held and distributed as provided for in Article SIXTH below.

2. Forty-five percent (45%) of such residue shall be distributed to Disney Foundation as Trustee, IN TRUST. Such Trust shall be known as the Charitable Trust and shall be held and distributed as provided for in Article SEVENTH below. If all or any portion of the gift provided for in this Paragraph 2 shall be invalid by reason of Probate Code Section 41, or any other provision of law limiting, restricting or invalidating gifts to charity, such bequest shall be carried out to the extent permitted by law and to the extent not so permitted shall go instead to the University of California.

3. Two and one-half percent (2½%) thereof shall be distributed to LILLIAN B. DISNEY, HERBERT F. STURDY and UNITED CALIFORNIA BANK as Trustees, IN TRUST, for the benefit of MARJORIE DAVIS (hereby designated a life income beneficiary) and NANETTE DAVIS, GEOFFREY DAVIS and MELINDA

DAVIS (hereby designated as remaindermen) to be held and distributed as a Residuary Trust as provided for in Article EIGHTH below.

4. Two and one-half percent 2½%) thereof shall be distributed to LILLIAN B. DISNEY, HERBERT F. STURDY and UNITED CALIFORNIA BANK as Trustees, IN TRUST, for the benefit of DOROTHY DISNEY PUDER (hereby designated a life income beneficiary) and LINDA PUDER, DAVID PUDER and PAUL PUDER (hereby designated as remaindermen), to be held and distributed as a Residuary Trust as provided for in Article EIGHTH below.

5. Two and one-half percent (2½%) thereof shall be distributed to LILLIAN B. DISNEY, HERBERT F. STURDY and UNITED CALIFORNIA BANK as Trustees, IN TRUST, for the benefit of RUTH FLORA BEECHER (hereby designated a life income beneficiary) and THEODORE BEECHER (hereby designated a remainderman) to be held and distributed as a Residuary Trust as provided for in Article EIGHTH below.

6. Two and one-half percent (2½%) thereof shall be distributed to LILLIAN B. DISNEY, HERBERT F. STURDY and UNITED CALIFORNIA BANK, as Trustees, IN TRUST, for the benefit of PHYLLIS BOUNDS (hereby designated a life income beneficiary) and ALEXANDRA DETIEGE, VICTORIA DETIEGE and CLANCY DETIEGE (hereby designated as remaindermen) to be held and distributed as a Residuary Trust as provided for in Article EIGHTH below.

SIXTH: DISNEY FAMILY TRUST:

1. In the event that my wife, LILLIAN B. DISNEY, shall survive me, the Trustees may pay to her or apply for her benefit so much of the net income and principal of the trust estate as the Trustees (other than LILLIAN B. DISNEY who shall not participate in the exercise of this discretion) deem necessary or proper for her health, support and maintenance. In the exercise of such discretion the Trustees shall take into consideration other income available to her for such purposes and held free of this trust. Any income which is not so applied or paid to LILLIAN B. DISNEY may be paid to or applied for the benefit of a group of persons consisting solely of my daughters, my grandchildren and any other issue of mine who are living at the time of my death, or who may be born afterwards, in such proportions and amounts as the Trustees, in their sole discretion, deem to be necessary or appropriate. The balance of the income which is not paid to or applied for the benefit of LILLIAN B. DISNEY or such group of persons shall be accumulated by the Trustees and added to the principal of the trust estate.

2. Upon the death of LILLIAN B. DISNEY (or upon my death in the event that she shall fail to survive me), the Trustees shall divide the trust estate into two equal shares. One-half (½) of the income from each share of the trust shall be paid to or applied for the benefit of each daughter of mine, in monthly or other convenient instalments, but no less often than quarterly, throughout their lifetimes. The other one-half (½) of the income from such share of the trust estate may be paid to or applied for the benefit of

a group of persons consisting solely of the daughter receiving the one-half (½) of the income of such share, my grandchildren and any other issue of mine who are living at the date of my death, or who may be born afterwards, in such proportion and amounts as the Trustees, in their sole discretion, determine to be necessary or appropriate. In making the payments from such other one-half (½) of this income the Trustees may pay more to or apply more for the benefit of one or more persons included in such group than the others, and distributions may be made to one or more persons included in such group and not to the others, if the Trustees deem such to be necessary or appropriate. The balance of such other one-half (½) of the income from a share which is not paid to or applied for the benefit of such group of persons shall be accumulated by the Trustees and added to the principal of such share of the trust estate. Upon the death of a daughter of mine the one-half (½) of the income of a share required to be distributed to such daughter during her lifetime under the provisions of this Paragraph 2 shall augment the other one-half (½) of the income with respect to such share distributable among such group of persons under the provisions of this Paragraph 2.

3. Upon the death of the last to survive of myself, LILLIAN B. DISNEY, DIANE DISNEY MILLER and SHARON DISNEY BROWN, the entire principal and accrued and undistributed income of the trust estate shall be divided into equal shares, one (1) share for each grandchild of mine who is then living and one (1) share for the then living issue, taken collectively, of each grandchild of mine who may then be deceased. The share set aside for each grandchild

of mine who has then attained age thirty (30) shall be distributed outright to such grandchild. The share set aside for each grandchild who has not then attained age thirty (30) shall continue to be held in trust, subject to the provisions of Paragraph 4 of this Article SIXTH. The share set aside for the issue of a deceased grandchild of mine shall be distributed outright to such issue upon the principle of representation, subject however, to the provisions of Paragraph 5 of this Article SIXTH.

4. In the event that under the provisions of the preceding paragraph a share shall continue to be held in trust for a grandchild of mine, the Trustees shall pay to or apply for the benefit of such grandchild all of the net income of such share in monthly or other convenient instalments, but no less often than quarterly, provided, however, that until such time as such grandchild attains age twenty-one (21) the Trustees shall only pay to or apply for the benefit of such grandchild so much of the net income of such share as the Trustees deem necessary or proper to provide for the grandchild's health, education, support and maintenance, and the balance of such income shall be accumulated and added to the principal of such share. At such time as a grandchild for whom a share is held in trust under the provisions of this Paragraph 4 attains age thirty (30) the Trustees shall distribute outright to the grandchild the entire remaining balance of such share. Should any grandchild for whom a share is held in trust under the provisions of this Paragraph 4 die prior to obtaining full distribution of such share, the Trustees shall distribute outright the then remaining balance of such grandchild's share of the lawful issue of such grandchild living at

the date of the grandchild's death, upon the principle of representation, subject however, to the provisions of Paragraph 5 of this Article SIXTH, and should no such issue be then living such remaining balance shall go to augment equally the shares then held for the benefit of, and those previously distributed to, my other grandchildren, excluding each grandchild theretofore deceased leaving no issue living at the time of such augmentation, but including, upon the principle of representation, the then living lawful issue of any deceased grandchild of mine.

5. In the event that under the foregoing provisions a portion of the trust estate becomes distributable to the issue of any deceased grandchild of mine and any such issue has not then attained age twenty-one (21), the Trustees shall hold, administer, invest and reinvest such issue's part of the trust estate for his or her benefit and shall apply so much of the net income and such portion of the principal thereof as the Trustees, in their discretion shall deem necessary for such issue's health, education, support and maintenance, or in the discretion of the Trustees, shall make such payments to the legal guardian of such issue or to the person with whom such issue may reside or directly to such issue, or otherwise, as the Trustees may from time to time deem advisable, and shall accumulate for the benefit of such issue any income not so applied or paid. When an issue for whom a portion shall have been retained under this provision attains age twenty-one (21), any of such portion then held for the benefit of such issue shall be distributed outright to the issue, and in the case of such issue's death prior thereto, shall forthwith be distributed to the issue's estate.

6. If the payment of income from this trust to which any child or grandchild of mine is entitled, should be insufficient, in the discretion of the Trustees, to provide for the health, education, support and maintenance of such child or grandchild, the Trustees may pay to or apply for the benefit of such child or grandchild so much of the principal of the trust estate as the Trustees may deem proper or necessary for such purposes; provided, however, that from and after the time that the trust estate is divided into separate shares for each grandchild of mine, payments of such principal for the benefit of a grandchild shall only be made from the principal of the share set aside for the grandchild, shall not exceed the principal of the share set aside for the grandchild and shall be deducted from it. In the exercise of discretion hereunder the Trustees shall take into consideration other income available to such child or grandchild for these purposes and held free of this trust.

7. In the event that under the foregoing provisions a portion of the trust estate shall be undisposed of, such undisposed of portion shall be distributed outright to my heirs. As used herein the word "heirs" shall mean those persons, other than creditors, who would take my separate personal property under the laws of the State of California if I had died on the date stipulated for distribution and domiciled in such State.

SEVENTH: CHARITABLE TRUST:

1. The Trustee shall divide the trust estate into two shares as follows: One share equal to five percent (5%) thereof shall be set aside for DISNEY FOUNDATION, and one share equal to ninety-five percent (95%) thereof shall be set aside for CALIFORNIA

INSTITUTE OF THE ARTS. Notwithstanding such division into shares, each share shall not constitute a separate trust, but rather, the entire trust estate provided for under this Article SEVENTH shall be held as one trust for the benefit of both organizations.

2. The entire net income from the share of the trust estate set aside for each such organization shall be distributed to the organization for which such share was set aside, in convenient instalments but no less often than annually.

3. In the event the Trustee shall determine that either of the above mentioned organizations shall be in further need of funds in order to carry out the purposes for which such organizations were formed, the Trustee may distribute to such organization so much of the principal of the share of the trust estate set aside for the benefit of such organization, up to the whole thereof, as the Trustee, in its sole and absolute discretion shall deem necessary or proper for such purposes. Distributions of principal of the trust estate may be made to one organization and not to the other, in the sole and absolute discretion of the Trustee. Any payment of principal, however, shall not exceed the principal of the share of the trust estate set aside for such organization and, in order that such organization will thereafter receive only that part of income of the trust estate which is proportionate to the undistributed share of such organization in such trust estate, such principal distribution shall be deducted from the share set aside for such organization. For example, if two percent (2%) of the principal of the entire trust estate were distributed to Disney Foundation, thereafter the share of the total income of the trust estate to be distributed to Disney Foundation would

be three percent (3%). Likewise, if two percent (2%) of the principal of the entire trust estate were thereafter distributed to California Institute of the Arts, thereafter the share of the total income of the trust estate to be distributed to California Institute of the Arts, would be ninety-three percent (93%).

4. In the event that the principal of the trust estate consists of shares of stock of Walt Disney Productions, or any other securities of such corporation or any other corporation, and the Trustee has decided to make a distribution of principal in accordance with the provisions of the preceding paragraph, the Trustee, in its sole and absolute discretion, may accomplish such principal distribution in any one or more of the following ways, either alone or in combination:

(a) Distribute the securities

(b) Sell the securities (which would otherwise have been distributed) to one or more third parties and distribute the net proceeds, or

(c) Purchase such securities in its individual capacity (at the closing price for such securities on the New York Stock Exchange on the date of purchase) and distribute the proceeds.

5. If the entire principal of the share of the trust estate set aside for California Institute of the Arts is distributed to it under the provisions of the foregoing paragraphs, the Trustee may terminate the trust and distribute outright to Disney Foundation the entire remaining balance of the trust estate. However, if the entire principal of the share of the trust estate set aside for Disney Foundation is distributed outright to it, the trust shall not terminate, but rather, the entire remaining balance of the trust estate shall then continue

to be held in trust solely for the benefit of California Institute of the Arts, subject to all of the terms and conditions of this Article SEVENTH.

EIGHTH: RESIDUARY TRUST:

1. The entire net income of each of the four Residuary Trusts created under the provisions of Paragraphs 3 through 6 of the Article FIFTH above shall be paid to or applied for the benefit of the person designated as a life income beneficiary in monthly or other convenient instalments, but no less often than quarterly, during the entire lifetime of such life income beneficiary.

2. Upon the death of such life income beneficiary (or upon my death in the event that such life income beneficiary does not survive me) the Trustee shall divide the particular Residuary Trust into equal shares as follows: One share for each then living person designated as a remainderman of such Residuary Trust and one share for the then living issue of each such remainderman who may then be deceased. The share set aside for each remainderman who has then attained age thirty (30) shall be distributed outright to him or her. The share set aside for each remainderman who has not then attained age thirty (30) shall continue to be held in trust, subject to the provisions of Paragraph 3 of this Article EIGHTH below. The share set aside for the issue of a deceased remainderman shall be distributed outright to such issue upon the principle of representation, subject however, to the provision of Paragraph 4 of this Article EIGHTH below.

3. In the event that under the provisions of the preceding paragraph a share of a Residuary Trust shall continue to be held in trust for a remainderman,

the Trustees shall pay to or apply for the benefit of such remainderman all of the net income of such share in monthly or other convenient instalments but no less often than quarterly; provided, however, that until such time as a remainderman attains age twenty-one (21) the Trustees shall only pay to or apply for the benefit of such remainderman so much of the net income of such share as the Trustees deem necessary or proper to provide for the remainderman's health, education, support and maintenance and the balance of such income shall be accumulated and added to the principal of such share. At such time as a remainderman for whom a share is held in trust under the provisions of this Paragraph 3 attains age thirty (30), the Trustees shall distribute outright to the remainderman the entire remaining balance of such share. Should any remainderman for whom a share is held in trust under the provisions of this Paragraph 3 die prior to obtaining full distribution of such share, the Trustees shall distribute outright the then remaining balance of such remainderman's share to the lawful issue of such remainderman living at the date of the remainderman's death, upon the principle of representation, subject however, to the provisions of Paragraph 4 of this Article EIGHTH below, and should no such issue be then living such remaining balance shall go to augment equally the shares then held for the benefit of, and those previously distributed to, the other remaindermen of the particular Residuary Trust, excluding each remainderman theretofore deceased leaving no issue living at the time of such augmentation, but including upon the principle of representation the then living lawful issue of any deceased remainderman of such particular Residuary Trust.

4. In the event that under the foregoing provisions a portion of a Residuary Trust becomes distributable to the issue of any deceased remainderman and any such issue has not then attained age twenty-one (21) the Trustees shall hold, administer, invest and reinvest such issue's part of the Residuary Trust for his or her benefit, and shall apply so much of the net income and such portion of the principal thereof as the Trustees in their discretion shall deem necessary for such issue's health, education, support and maintenance, or in the discretion of the Trustees, shall make such payments to the legal guardian of such issue or to the person with whom such issue may reside or directly to such issue, or otherwise, as the Trustees may from time to time deem advisable, and shall accumulate for the benefit of such issue any income not so applied or paid. When an issue for whom a portion shall have been retained in trust under this provision attains age twenty-one (21), any of such portion then held for the benefit of such issue shall be distributed outright to the issue, and in the case of such issue's death prior thereto, shall forthwith be distributed to the issue's estate.

5. If the payments of income from a Residuary Trust to which any life income beneficiary or remainderman is entitled should be insufficient, in the discretion of the Trustees to provide for the health, education, support and maintenance of such life income beneficiary or remainderman, the Trustees may pay to or apply for the benefit of such life income beneficiary or remainderman so much of the principal of the Residuary Trust as the Trustees may deem proper or necessary for such purposes; provided however, that from and after the time that a Residuary Trust is divided into

separate shares for the remainderman, payments of such principal for the benefit of a remainderman shall only be made from the principal of the share set aside for the remainderman, shall not exceed the principal of the share set aside for the remainderman and shall be deducted from it. In the exercise of discretion hereunder the Trustees shall take into consideration other income available to a life income beneficiary or remainderman for these purposes and held free of a Residuary Trust.

6. In the event that under the foregoing provisions a portion of a Residuary Trust shall be undisposed of, such undisposed of portion shall augment the principal of the Disney Family Trust provided for under the terms of Article SIXTH above and shall be held, administered and distributed as provided therein.

NINTH: POWERS OF TRUSTEES:

To carry out the purposes of the trusts created hereunder and subject to any limitations set forth elsewhere in this instrument the Trustees are vested with the following powers, in addition to any now or hereafter conferred by law:

1. To continue to hold any property, including stock of a Trustee corporation, and to operate at the risk of the Trust Estate and not at the risk of the Trustees, any property or business received in this Trust, including specifically any shares of stock of Walt Disney Productions, Inc. and Retlaw Enterprises, Inc. (or any successor of such corporations), as long as the Trustees may deem advisable, the profits and losses therefrom to inure to or be chargeable to the Trust Estate as a whole and not to the Trustees. The

Trustees shall not be required to sell any of such assets merely for the sake of diversifying trust investments, or for the sake of obtaining funds to purchase assets that produce more income.

2. To manage, control, sell, convey, exchange, partition, divide, subdivide, improve, repair; to grant options and to sell upon deferred payments, to lease for terms within or extending beyond the duration of the Trust for any purpose, including exploration for and removal of gas, oil and other minerals; to compromise, arbitrate or otherwise adjust claims in favor of or against the Trust; to create restrictions, easements and other servitudes; to carry such insurance as the Trustees may deem advisable.

3. To invest and reinvest the principal, and income if accumulated, and to purchase or acquire therewith every kind of property, real, personal or mixed, and every kind of investment specifically including, but not by way of limitation, corporate obligations of every kind and stocks, preferred or common; to invest in any common trust fund now or hereafter established by a corporate Trustee.

4. To advance funds to said Trust for any trust purpose, such advances with interest at current rate to be a first lien on and to be repaid out of principal or income; to reimburse Trustees from principal or income for any loss or expense incurred by reason of Trustees' ownership or holding of any property in this Trust.

5. To borrow money for any trust purpose upon such terms and conditions as the Trustees

may deem proper, and to obligate the Trust Estate for repayment; to encumber the Trust Estate or any of its property by mortgage, deed of trust, pledge or otherwise, using such procedure to consummate the transaction as the Trustees may deem advisable.

6. To have respecting securities all the rights, powers and privileges of an owner, including, without limiting the foregoing, the power to give proxies, pay calls, assessments and other sums deemed by the Trustees necessary for the protection of the Trust Estate; to participate in voting trusts, pooling agreements, foreclosures, reorganizations, consolidations, mergers and liquidations, and in connection therewith to deposit securities with and transfer title to any protective or other committee under such terms as the Trustees may deem advisable; to exercise or sell stock subscription or conversion rights; to accept and retain as an investment hereunder any securities received through the exercise of any of the foregoing powers.

7. Upon any division or partial or final distribution of the Trust Estate, to partition, allot and distribute the Trust Estate in undivided interests or in kind or partly in money and partly in kind, at such valuation and according to such method or procedure as the Trustees may determine, and to sell such property as the Trustees may deem necessary to make such division or distribution.

8. To budget the estimated annual income and expenses of the Trust in such manner as to equalize, as far as practicable, periodical income payments to beneficiaries.

9. In the determination of what is income or principal of the Trust Estate the Trustees shall be governed by the provisions of the California Principal and Income Act from time to time existing; provided however, that any stock dividends of five percent (5%) or less paid by Walt Disney Productions (or any successor corporation) shall be considered income rather than principal.

10. The enumeration of certain powers of the Trustees shall not limit their general or implied powers, and the Trustees, subject always to the discharge of their fiduciary obligations, are vested with and shall have all the rights, powers and privileges which an absolute owner of the same property would have; provided however, that none of the foregoing powers shall be construed to allow the Trustees to transfer trust property to any person other than the designated Trust beneficiaries without receiving fair and adequate consideration.

11. In the event that there shall be included as an asset of the trust estate one or more parcels of residential real property (or a fractional interest therein) the Trustees are authorized to hold such properties as an asset of the trust estate so long as my wife, Lillian B. Disney, is living and shall desire to occupy such residential real property. If my wife does occupy such residence or residences she shall be able to do so without payment of rent and shall generally manage, care for and protect it, but the Trustees may pay a proportionate amount of any taxes, assessments, liens and insurance on such properties and a similar proportion of the expenses and repair and replacements to any buildings thereon. The Trustees shall

have no other responsibilities as to such properties while they are being occupied by my wife but the Trustees may carry insurance for the protection of the trust estate at the expense of the trust estate. At such time as my wife no longer desires to occupy such residence, or upon her death, the Trustees shall sell the residences and the proceeds shall become part of the trust estate.

TENTH: GENERAL PROVISIONS.

Subject to any limitations stated elsewhere in this instrument the following additional provisions shall apply to all trusts and trust estates created hereunder:

1. Each and every beneficiary shall be without right, power or authority to sell, assign, pledge, mortgage or in any other manner to encumber, alienate, or impair his or her beneficial or legal interest in the Trust, or any part thereof, or in the principal or income thereof, and the beneficial and legal interest in and the principal and the income of the Trust and every part thereof shall be free from the interference or control of creditors of each and every beneficiary of the Trust and shall not be subject to the claims of any creditor of any beneficiary, nor liable to attachment, execution, bankruptcy or any other process of law, and the income and principal of the Trust shall be paid over to the beneficiary in person, or in the event of minority or incompetency of the beneficiary, then to the duly appointed guardian of the beneficiary, or to or for the benefit of the beneficiary in such manner as in the Trustees' discretion seems most advisable, at the time and in the manner herein provided and not upon any written or verbal order nor upon any assignment

or transfer thereof by the beneficiary or by operation of law.

2. Whenever the Trust Estate hereunder is divided into separate shares, each such share shall constitute a separate and distinct trust, but the Trustees shall not be required to make physical segregation of the trust assets and may hold property in undivided interests in each of such trusts. The Trustees may, however, make physical segregation if that seems necessary or advisable in their discretion.

3. Income accrued or unpaid on trust property when received into the Trust shall be treated as any other income.

4. Upon the death of any beneficiary, any accrued or undistributed income which would have been payable to such beneficiary had such beneficiary continued to live, shall be paid to the person or persons who may be entitled to the payment of income on the day on which income next is payable or who may be entitled to the transfer of principal upon such beneficiary's death.

5. The Trustees may make payments to any beneficiary under disability by making them to the guardian of the person of the beneficiary, or directly to the beneficiary, or may apply them for the beneficiary's benefit. In the case of a minor, payments may also be made to either parent, or may be made directly to any minor who, in the judgment of the Trustees, is sufficiently mature to judiciously use the same.

6. The terms "child," "grandchildren," "issue," and "heirs" whenever used in this instrument shall include legally adopted children.

7. Any Trustee shall have the right to resign the trusteeship at any time. Upon resignation or inability to act of any Trustee, a successor Trustee shall be appointed in the manner provided herein with respect to successor Trustees. No bond shall be required of any Trustee named herein nor of any successor Trustee who may be appointed hereunder.

8. Until the Trustees shall receive written notice of any birth, marriage, death or other event upon which the right to payments from this Trust may depend, the Trustees shall incur no liability to persons whose interests may have been affected by that event for disbursements made in good faith.

9. The Trustees shall be fully protected in any action or nonaction taken, permitted or suffered in good faith and in accordance with the opinion of their counsel, and in case of legal proceedings involving the Trustees or the principal or income of the trust estates, the Trustees may defend such proceedings, or may, upon being advised by counsel that such action is necessary or advisable for the protection of the interests of the Trustees or of the beneficiaries, institute any legal proceedings.

10. Anything to the contrary notwithstanding, no trust created hereunder (except the Charitable Trust provided for in Article SEVENTH above which shall continue indefinitely as provided for therein) shall continue for a period longer than twenty-one (21) years after the death of the last to die of all of the beneficiaries thereof living at the date of my death, and any trust which does not otherwise terminate prior to that date

shall terminate on that date and thereupon the Trustees shall distribute and deliver free and clear of any trust the then remaining balance of principal and undistributed net income to the persons who are at that time entitled to income from each trust or portion of a trust on such termination date, and in the same proportions as they are entitled to receive the income at such time.

ELEVENTH: SUCCESSOR TRUSTEES:

In the event of the death, resignation or incapacity of LILLIAN B. DISNEY, she shall be succeeded as a Co-Trustee by DIANE DISNEY MILLER, and in the event of the death, resignation or incapacity of DIANE DISNEY MILLER, she shall be succeeded as a Co-Trustee by SHARON DISNEY BROWN and in the event of the death, resignation or incapacity of SHARON DISNEY BROWN, a successor Co-Trustee shall be appointed by the remaining two Co-Trustees. In the event of the death, resignation or incapacity of HERBERT F. STURDY, a successor Co-Trustee shall be appointed by the remaining two Co-Trustees; provided however, that such Co-Trustees shall give consideration to appointing another partner in the law firm of Gibson, Dunn & Crutcher to serve as such successor Co-Trustee. All rights, powers, duties and discretions herein conferred upon the original Trustees shall vest in all successor Trustees.

TWELFTH: Except as I may otherwise expressly provide in writing in connection with any transfer made prior to my death, I direct that all estate, inheritance and succession taxes imposed by the Federal Government or by any country, state, district or territory, and occasioned or payable by reason of my death,

whether or not attributable to property subject to probate administration, shall be chargeable to and paid out of the residue of my estate provided for under the terms of Article FIFTH above without apportionment, deduction or reimbursement therefor, and without adjustment thereof among the residuary beneficiaries.

THIRTEENTH: Except as otherwise provided in this Will, I have intentionally and with full knowledge omitted to provide for my heirs, including any persons who may claim to be an issue of mine.

FOURTEENTH: If any devisee, legatee or beneficiary under this Will or any legal heir of mine, or person claiming under any of them, shall contest this Will or attach or seek to impair or invalidate this Will, or any part or provision hereof, or conspire with or voluntarily assist anyone attempting to do any of those things, in that event I specifically disinherit each such person and all legacies, bequests, devises and interests given under this Will to that person shall be forfeited and shall augment proportionately the shares of my estate going under this Will to or in trust for such of my devisees, legatees and beneficiaries as shall not have participated in such acts or proceedings. If all my devisees, legatees and beneficiaries shall participate in such proceedings, I give, devise and bequeath the whole of my estate to my heirs-at-law excluding all of the aforesaid persons as if they had predeceased me.

FIFTEENTH: I nominate and appoint my wife, LILLIAN B. DISNEY, HERBERT F. STURDY and UNITED CALIFORNIA BANK, as Co-Executors of this Will. In the event that either my wife or HERBERT F. STURDY shall be unable to act as such or shall fail to complete the administration of my

estate, then the other shall serve as Co-Executor along with UNITED CALIFORNIA BANK and in the event that both my wife and HERBERT F. STURDY are unable to act as such or shall fail to complete the administration of my estate then UNITED CALIFORNIA BANK shall be the sole Executor. No bond shall be required of any individual while acting as a Co-Executor hereunder. Such Co-Executors shall have full power and authority to lease, sell, exchange or encumber the whole or any part of my estate, without notice, but subject to such confirmation as may be required by law and may continue to hold, manage and operate any property, and, subject to court approval, any business belonging to my estate. I further authorize and empower my Co-Executors, upon any division of my estate, or upon any partial or final distribution of my estate, to partition, allot and distribute my estate in undivided interests or in kind or partly in money and partly in kind according to such method or procedure as my Co-Executors shall determine; provided however, that in making an allocation of assets to the various trust created under the provisions of Article FIFTH above, any shares of stock of Retlaw Enterprises, Inc., or any successor corporation, or any interest in residential real properties which are included in the residue of my estate shall only be allocated to the Disney Family Trust provided for thereunder.

IN WITNESS WHEREOF, I have hereunto set my hand this 18th day of March 1966.

/s/ Walter E. Disney
WALTER E. DISNEY

The foregoing instrument consisting of fifteen (15) pages, including the page upon which this attestation is completed, was at the date thereof by the said WALTER E. DISNEY signed and sealed and published as and declared by him to be his Last Will and Testament in the presence of us, who, at his request and in his presence and in the presence of each other, have subscribed our names as witnesses thereto.

/s/ Royal Clark Residing at Yorba Linda

/s/ Ronald E. Gother Residing at San Gabriel, Calif.

/s/ William H. Cottrell Residing at North Hollywood, Calif.

EXHIBIT B.

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"AMENDED RETURN"

FORM 1041 — U.S. Fiduciary Income Tax Return

U.S. Treasury Department
Internal Revenue Service

(FOR ESTATES AND TRUSTS) FOR CALENDAR YEAR 1967

or other taxable year beginning 1967,
and ending ..... 19.....

PLEASE TYPE OR PRINT

1967

Check whether:
- [X] Estate
- [ ] Simple trust
- [ ] Complex trust

If trust, check whether:
- [ ] Testamentary
- [ ] Inter vivos

Name of estate or trust: Walter E. Disney
Employer Identification Number: 95-6145544

Name and title of fiduciary: United California Bank - Co-Executor

Address of fiduciary (number and street): 600 South Spring Street

City, State, and ZIP code: Los Angeles, California 90054

Simple trusts are not required to fill in Schedules E, F, and G. They need complete only the lines and schedules that apply to them. See page 2 of instructions.

INCOME	1 Dividends (enter full amount before exclusion)	57,360.50	
	2 Interest on bank deposits, notes, corporation bonds, etc	19,120.28	
	3 Interest on tax-free covenant bonds upon which a Federal income tax was paid at source		
	4 Interest on Government obligations	486.67	
	5 Income from partnerships and other fiduciaries (instruction 5)		
	6 Gross rents and royalties	4.50	
	7 Gross profit (or loss) from trade or business		
	8 (a) Net gain (or loss) from sale or exchange of capital assets (from line 11, Schedule D)	517,566.54	
	(b) Net gain (or loss) from sale or exchange of property other than capital assets (from line 23, Schedule D)		
	9 Other income (state nature of income)		
	10 Total income (lines 1 to 9, inclusive)		594,538.49
DEDUCTIONS	11 Interest (Schedule A)	17,377.39	
	12 Taxes (Schedule A)	5,207.78	
	13 Fiduciary's portion of depreciation (Schedule B) and depletion. Explain depletion		
	14 Charitable deduction (line 9, Schedule E)	144,738.96	
	15 Other deductions authorized by law (Schedule A)		
	16 Total (lines 11 to 15, inclusive)		167,324.13
	17 Line 10 minus line 16. (Complex trusts and estates enter this amount on line 1 in Schedule F, also)		427,214.36
	18 Deduction for distributions to beneficiaries (instruction 18)	29,912.73	
	19 Adjustment of dividend exclusion (not to exceed $100) (instruction 19)		
	20 Federal estate tax attributable to income in respect of a decedent (Fiduciary's share)		
	21 Long-term capital gain deduction. Enter 50% of line 12(e), Schedule D	250,311.19	
	22 Exemption (instruction 22)	600.00	
	23 Total (lines 18 to 22, inclusive)		280,823.92
	24 Taxable income of fiduciary (line 17 minus line 23)		146,390.44
COMPUTATION OF TAX	25 Tax on amount on line 24 (see tax rate schedule in instruction 25)		87,963.31
	26 If alternative tax is applicable, enter the tax from line 21, Schedule D		70,666.97
	27 Fiduciary's share of foreign tax credit (Form 1116)		
	28 Fiduciary's share of investment credit (see instruction 38 and attach Form 3468)		
	29 Total (lines 27 and 28)		
	30 Balance (line 25 or 26, whichever is applicable, less line 29)		
	31 Tax from recomputing fiduciary's share of prior year investment credit (attach statement)		
	32 Total (lines 30 and 31)		
	33 Fiduciary's share of credit for tax paid at source on tax-free covenant bond interest		
	34 Credit for nonhighway Federal gasoline tax—Form 4136, and Reg. Inv.—Form 2439		
	35 Tax previously paid, or withheld (see instruction 35 and attach explanation)	82,964.98	
	36 Total (lines 33, 34, and 35)		82,964.98
	37 Balance of tax or overpayment (line 32 less line 36)		(12,298.01)

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief it is true, correct, and complete. If prepared by a person other than taxpayer, his declaration is based on all information of which he has any knowledge.

United California Bank
By:
Lillian B. Disney — Signature of fiduciary or officer representing fiduciary — Date
Co-Executrix — Signature of preparer other than fiduciary — Address — Date

Schedule A.—EXPLANATION OF DEDUCTIONS CLAIMED ON LINES 11, 12, AND 15, PAGE 1 (see instruction 36)

Line No.	Explanation	Amount	Line No.	Explanation	Amount
11	Interest paid on creditors claim of United California Bank.	16,796.93	12	Additional State tax due	2,479.50
11	Interest paid additional Franchise Tax due	580.46	12	1966 State tax due	185.46
			12	1967-68 Real Estate Tax	2,542.82

Schedule B.—EXPLANATION OF DEDUCTION FOR DEPRECIATION (see instruction 37)

This schedule is designed for taxpayers using the alternative guidelines and administrative procedures described in Revenue Procedures 62-21 and 65-13 as well as for those taxpayers who wish to continue using practices authorized prior to these revenue procedures. Where double headings appear use the first heading for depreciation under Revenue Procedures 62-21 and 65-13 and the second heading for other authorized practices.

1. Group and guideline class — OR — Description of property	2. Cost or other basis at beginning of year — OR — Cost or other basis	3. Asset additions in year (amount) — OR — Date acquired	4. Asset retirements in year (amount) (applicable only to Rev. Proc. 62-21)	5. Depreciation allowed or allowable in prior years	6. Method of computing depreciation	7. Class life — OR — Rate (%) or life	8. Depreciation for this year
1 Total additional first-year depreciation—estates only (do not include in items below) →							
2 Totals							
3 Less: Amount of depreciation claimed elsewhere in this return							
4 Balance (line 2 less line 3)							
5 Fiduciary's portion of line 4. Enter here and on line 13, page 1							

Schedule C.—BENEFICIARIES' SHARES OF INCOME AND CREDITS (estates and complex trusts, see instruction 38)

1. Name of each beneficiary (Designate nonresident aliens, if any)	2. Address (Where return of beneficiary is filed in another internal revenue district, specify district, if known)	3. Social security number
(a) Disney Foundation As Trustee Of	Burbank, California	
(b) The Charitable Trusts		
(c)		
(d)		

Continuation of Schedule C

	4. Amount of income required to be distributed currently	5. Other amounts paid, credited, or otherwise required to be distributed	6. Domestic dividends qualifying for exclusion	7. Income taxable to beneficiaries less portion reportable in cols. 6, 8, 9, and 10
(a)	33,404.22	104,850.00	22,291.36	7,621.37
(b)				
(c)				
(d)				
Totals				

Continuation of Schedule C

	8. Net short-term capital gain	9. Net long-term capital gain (100%)	10. Tax-exempt income (enter total only)	11. Federal income tax paid at source (2% of line 3, page 1, less line 33, page 1)	12. Income and profits taxes paid to a foreign country or United States possession	13. Depreciation and depletion
(a)						
(b)						
(c)						
(d)						
Totals			3,491.49			

ADDITIONAL INFORMATION REQUIRED

1 Was a Form 1041 filed for last year? [ ] Yes [X] No. If "Yes," to which District Director's office was it sent? .....

2 Date trust was created or, if an estate, date of decedent's death. December 15, 1966

3 If copy of will or trust instrument and statement required under General Instruction "H" has been filed, do not file again but enter date and place where filed. .....

4 If you had tax-exempt income, have you deducted only that portion of expenses allocable to taxable income? [X] Yes [ ] No.

5 If return is for a trust, enter name and address of grantor: .....

6 If return is for an estate, has a United States Estate Tax Return been filed? [X] Yes [ ] No. If "No," will return be filed? [ ] Yes [ ] No [ ] Uncertain.

7 Has final distribution of assets been made during the year? [ ] Yes [X] No. If answer is "Yes," see instruction 22.

ACCOUNT Walter E. Disney NO. 1-32-1903-1/3

UNITED CALIFORNIA BANK
600 SOUTH SPRING STREET
LOS ANGELES, CALIFORNIA 90054

AMENDED

SCHEDULE OF CAPITAL GAINS AND LOSSES

YEAR 1967

DESCRIPTION OF PROPERTY	DATE ACQUIRED	DATE SOLD	AMOUNT REALIZED	COST	FEDERAL RETURN		STATE RETURN	
					SHORT-TERM GAIN OR LOSS	LONG-TERM GAIN OR LOSS	SHORT-TERM GAIN OR LOSS	LONG-TERM GAIN OR LOSS
Capital Gains and Losses Received								
from Account Number:								
1-32-1903-1					2,400.00	500,786.55	2,400.00	414,076.55
1-32-1903-3					14,544.16	(164.17)	14,544.16	(164.17)
NET LONG-TERM AND SHORT-TERM GAIN OR LOSS					16,944.16	500,622.38	16,944.16	413,912.38
LESS PORTION TAXABLE TO BENEFICIARIES								
PORTION TAXABLE TO FIDUCIARY (ENTER TOTAL NET GAIN OR LOSS TO APPROPRIATE SCHEDULE)								
ENTER HERE AND ON PAGE 1 OF TAX RETURNS 50% OF FIDUCIARY'S L/T GAIN LESS S/T LOSS								

TRUST DEPT. (TAX DIV.) D

ACCOUNT Walter E. Disney NO. 1-32-1903-1

UNITED CALIFORNIA BANK
600 SOUTH SPRING STREET
LOS ANGELES, CALIFORNIA 90054

SCHEDULE OF CAPITAL GAINS AND LOSSES

AMENDED

YEAR 1967

DESCRIPTION OF PROPERTY	DATE ACQUIRED	DATE SOLD	AMOUNT REALIZED	COST	FEDERAL RETURN		STATE RETURN	
					SHORT-TERM GAIN OR LOSS	LONG-TERM GAIN OR LOSS	SHORT-TERM GAIN OR LOSS	LONG-TERM GAIN OR LOSS
13,000 Shares Walt Disney Productions	12-15-66	6-22-67	1,281,826.55					
				F.781,040.00 S 867,750.00		500,786.55		414,076.55
One-half interest in Escrow Receipt								
for 50 Shares Retlaw Enterprises, Inc.								
Certificate Number 9 Registered name								
of Walter E. Disney. Held by Escrow.								
Holder, Herbert F. Sturdy in exchange								
for five (5) promissory notes pursuant								
to court order dated 6-5-67	12-15-66	6-5-67	1,315,987.50					
				1,315,987.50	-0-		-0-	
50,000 Shares California State								
Construction Prog. Ser. K. 3.25%								
Due 7-1-87	12-15-66	5-1-67	46,050.00	43,650.00	2,400.00		2,400.00	
NET LONG-TERM AND SHORT-TERM GAIN OR LOSS					2,400.00	500,786.55	2,400.00	414,076.55
LESS PORTION TAXABLE TO BENEFICIARIES								
PORTION TAXABLE TO FIDUCIARY (ENTER TOTAL NET GAIN OR LOSS TO APPROPRIATE SCHEDULE)								
ENTER HERE AND ON PAGE 1 OF TAX RETURNS 50% OF FIDUCIARY'S L/T GAIN LESS S/T LOSS								

TRUST DEPT. (TAX DIV.) D

Walter Elias D. Disney NO. 1-32-1903-3

UNITED CALIFORNIA BANK
600 SOUTH SPRING STREET
LOS ANGELES, CALIFORNIA 90054

SCHEDULE OF CAPITAL GAINS AND LOSSES

AMENDED

YEAR 1967

DESCRIPTION OF PROPERTY	DATE ACQUIRED	DATE SOLD	AMOUNT REALIZED	COST	FEDERAL RETURN		STATE RETURN	
					SHORT-TERM GAIN OR LOSS	LONG-TERM GAIN OR LOSS	SHORT-TERM GAIN OR LOSS	LONG-TERM GAIN OR LOSS
5000 Anaheim U.H.S.D. Ser. A Due 12-1-77	12-15-66	4-28-67	5,029.50	4,600.00	429.50		429.50	
12,000 California Veteran - Series B 3.625% Due 4-1-87	12-15-66	4-28-67	11,841.60	10,860.00	981.60		981.60	
5000 California Veterans - Series P 3.25% Due 10-1-80	12-15-66	4-26-67	4,693.00	4,400.00	293.00		293.00	
100,000 L.A. Department of Water & Power Elec. Plt Rev 3.3% Due 4/1/87	12-15-66	5-1-67	92,680.00	87,000.00	5,680.00		5,680.00	
50,000 L.A. Department of Water & Power Elec. Plt Rev. 3.4% Due 4-1-91	12-15-66	5-5-67	46,430.00	44,000.00	2,430.00		2,430.00	
5000 Los Angeles Department of Water & Power Rev 2.7% Due 1-1-80	12-15-66	4-26-67	4,269.00	3,937.50	331.50		331.50	
10,000 Los Angeles City High School District Series E 4% Due 1-1-72	12-15-66	4-26-67	10,289.00	9,900.00	389.00		389.00	
10,000 Los Angeles City Replace Hosp. Fac. 4% Due 7-1-76	12-15-66	4-26-67	10,405.00	9,850.00	555.00		555.00	
10,000 Petaluma City High School Dist. Series A 3.75 Due 2-15-79	12-15-66	4-28-67	10,218.00	9,615.00	603.00		603.00	
38,000 San Diego Sewer Rev 4% due 6-1-2001	12-15-66	4-25-67	37,814.56	35,242.50	2,572.06		2,572.06	
5,000 San Diego Water County Authority Series D 3.8% due 2-1-80	12-15-66	4-25-67	5,029.50	4,750.00	279.50		279.50	
1/3 Interest in Parcel 1 S of 1/2 of W 1/2 of NW 1/4 of SE 1/4 of Section 10 Trr R 6 E Riverside City Expenses of Sale	12-15-66	8-17-67	20,000.00	20,000.00 202.18		(202.18)		(202.18)
44/100 Sh Walt Disney Productions		11-28-67	38.01			38.01		38.
NET LONG-TERM AND SHORT-TERM GAIN OR LOSS					14,544.16	(164.17)	14,544.16	(164.17)
LESS PORTION TAXABLE TO BENEFICIARIES								
PORTION TAXABLE TO FIDUCIARY (ENTER TOTAL NET GAIN OR LOSS TO APPROPRIATE SCHEDULE)								
ENTER HERE AND ON PAGE 1 OF TAX RETURNS 50% OF FIDUCIARY'S L/T GAIN LESS S/T LOSS								

TRUST DEPT. (TAX DIV.) D

Schedule D.—GAINS AND LOSSES FROM SALES OR EXCHANGES OF PROPERTY (see instruction 39)

Part I—CAPITAL ASSETS

Short-Term Capital Gains and Losses—Assets Held Not More Than 6 Months

a. Kind of property (if necessary, attach statement of descriptive details not shown below)	b. Date acquired (mo., day, yr.)	c. Date sold (mo., day, yr.)	d. Gross sales price	e. Depreciation allowed (or allowable) since acquisition	f. Cost or other basis, cost of subsequent improvements (if not purchased, attach explanation) and expense of sale	g. Gain or loss (d plus e less f)
1						
SEE ATTACHED SCHEDULE						16,944.16
2 Enter your share of net short-term gain (or loss) from partnerships and other fiduciaries						
3 Enter unused short-term capital loss carryover from preceding taxable years (attach statement)						
4 Net short-term gain (or loss) from lines 1, 2, and 3. Enter here and on line 9 below						16,944.16

Long-Term Capital Gains and Losses—Assets Held More Than 6 Months

5						
SEE ATTACHED SCHEDULE						500,622.38
6 Enter the full amount of your share of net long-term gain (or loss) from partnerships and other fiduciaries						
7 Enter unused long-term capital loss carryover from preceding taxable years (attach statement)						
8 Net long-term gain (or loss) from lines 5, 6, and 7. Enter here and on line 10 below						500,622.38

CAPITAL GAINS AND LOSSES

	1. Beneficiaries	2. Fiduciary	3. Total
9 Net short-term gain or loss from line 4, above		16,944.16	16,944.16
10 Net long-term gain or loss from line 8, above		500,622.38	500,622.38
11 Total net gain or loss		517,566.54	517,566.54

Enter on line 8(a), page 1, the net gain shown on line 11, column 3, above. If net loss on line 11, column 3, above, enter as loss on line 8(a), page 1, whichever of the following is the smallest amount: (i) the amount of the loss, (ii) taxable income computed without regard to capital gains and losses and the deduction for personal exemption, or (iii) $1,000.

COMPUTATION OF FIDUCIARY'S CAPITAL GAINS DEDUCTION

12(a) Long-term capital gain shown on line 10, column 3, above	500,622.38
(b) Short-term capital loss shown on line 9, column 3, above	-0-
(c) Excess of line 12(a) over line 12(b), above	500,622.38
(d) Long-term capital gains taxable to beneficiaries. (Total of column 9, Schedule C)	-0-
(e) Balance (line 12(c) minus line 12(d)). (Enter 50% of this amount on line 21, page 1)	500,622.38

Part II—GAIN FROM DISPOSITION OF DEPRECIABLE PROPERTY UNDER SECTIONS 1245 AND 1250—Assets Held More Than 6 Months—Where double headings appear, use the first heading for section 1245 and the second heading for section 1250.

a. Kind of property (if necessary, attach statement of descriptive details not shown below—write 1245 or 1250 to indicate type of asset)	b. Date acquired (mo., day, yr.)	c. Date sold (mo., day, yr.)	d. Gross sales price	e. Cost or other basis, cost of subsequent improvements (if not purchased, attach explanation) and expense of sale
13				

f. Depreciation allowed (or allowable) since acquisition		g. Adjusted basis (e less sum of f-1 and f-2)	h. Total gain (d less g)	i. Ordinary gain (lesser of f-2 or h) — OR — (see instructions)	j. Other gain (h less i)
f-1. Prior to January 1, 1962 — OR — Prior to January 1, 1964	f-2. After December 31, 1961 — OR — After December 31, 1963				

14 Total ordinary gain. Enter here and in column g, line 22, Part III

15 Total other gain. Enter here and in column g, line 5, Part I; however, if the gains do not exceed the losses when this amount is combined with other gains and losses from section 1231 property enter the total of column j in column g, line 22, Part III

COMPUTATION OF ALTERNATIVE TAX

If fiduciary had a net long-term capital gain or an excess of net long-term capital gain over net short-term capital loss shown in column 2, line 11, page 3, and line 24, page 1, exceeds $26,000, it may be to his advantage to make the alternative tax computation.

16 Income from line 24, page 1	146,390.44
17 50% of amount on line 12(e), page 3	137,671.15
18 Balance (line 16 minus line 17)	8,719.29
19 Tax on amount on line 18 (see tax rate schedule in instruction 25)	1,831.40
20 50% of amount on line 17, above	68,835.57
21 Alternative tax (line 19 plus line 20); if less than line 25, page 1, enter this amount on line 26, page 1	70,666.97

Part III—PROPERTY OTHER THAN CAPITAL ASSETS

a. Kind of property (if necessary, attach statement of descriptive details not shown below)	b. Date acquired (mo., day, yr.)	c. Date sold (mo., day, yr.)	d. Gross sales price	e. Depreciation allowed (or allowable) since acquisition	f. Cost or other basis, cost of subsequent improvements (if not purchased, attach explanation) and expense of sale	g. Gain or loss (d plus e less f)
22						
23 Net gain (or loss). Enter here and on line 8(b), page 1						

Schedule E.—COMPUTATION OF CHARITABLE DEDUCTION (see instruction 40)
(Submit statement giving name and address of charitable organization) "SEE SCHEDULE C".

1 Amounts paid or permanently set aside for charitable purposes from current year's income		27,330.73
2 Tax-exempt interest allocable to charitable distribution	2,856.68	
(Complete lines 3 and 4 below only if gain on line 10, column 2, Schedule D, exceeds loss on line 9, column 2, Schedule D)		
3 (a) Long-term capital gain included on line 1 (Do not complete lines (b) and (c) if such amounts are greater than line (a))		
(b) Enter gain on line 10, column 2, Schedule D, minus loss on line 9, column 2, Schedule D		
(c) Enter gain on line 10, column 3, Schedule D, minus loss on line 9, column 3, Schedule D		
4 Enter 50% of the smallest of line 3(a), line 3(b), or line 3(c)		2,856.68
5 Enter sum of line 2 and line 4		24,474.05
6 Balance (line 1 minus line 5)		120,264.91
7 Enter short-term capital gains and 50% of the long-term capital gains of the current taxable year allocable to corpus, paid or permanently set aside for charitable purposes		
8 Amounts paid or permanently set aside for charitable purposes other than from income of the current year		144,738.96
9 Total (line 6 plus lines 7 and 8). Enter here and on line 14, page 1		

Schedule F.—COMPUTATION OF DISTRIBUTABLE NET INCOME (see instruction 41)

1 Enter amount from line 17, page 1	
2 Add: (a) Tax-exempt interest (as adjusted)	
(b) Net gain shown on line 11, column 1, Schedule D. If net loss, enter zero	
(c) Lines 4 and 7, Schedule E	
(d) Short-term capital gain included on line 1, Schedule E	
(e) If amount on line 8(a), page 1, is a loss, enter amount here	
3 Total (line 1 through line 2(e))	
4 If amount on line 8(a), page 1, is a gain, enter amount here	
5 Distributable net income (line 3 minus line 4)	

Schedule G.—COMPUTATION OF DISTRIBUTIONS DEDUCTION (see instruction 42)

1 Total of columns 4 and 5 of Schedule C	
2 Enter the total of column 10, Schedule C	
3 Balance (line 1 minus line 2)	
4 Enter distributable net income (line 5, Schedule F)	
5 Enter the amount from line 2(a), Schedule F	
6 Balance (line 4 minus line 5)	
7 Distributions deduction. (Enter here and on line 18, page 1, the lesser of line 3 or line 6 above)	

During the taxable year did you make an accumulation distribution as defined in sec. 665(b)? See general instruction O. ☐ Yes ☐ No. If "Yes," attach Schedule J (Form 1041).

☆☆☆☆ U.S. GOVERNMENT PRINTING OFFICE : 1967—O-260-018

EXHIBIT C.

SCHEDULE E (Form 1041) U.S. Treasury Department Internal Revenue Service	**Beneficiary's Share of Income, Deductions, and Credits—1968** for the year January 1–December 31, 1968, or other taxable year beginning _____, 1968, ending _____, 19__ (Complete for each beneficiary—See instructions on back of Copy C)	Copy A File with Form 1041

Income		Deductions and credits	
1 Dividends qualifying for exclusion	33,942.96	5 Depreciation and depletion	
2 Short-term capital gain		6 Foreign tax credit	
3 Long-term capital gain		7 Other (specify)	
4 Other taxable income	105,733.65		

Name, identifying number, and address (including ZIP code) of beneficiary

Disney Foundation As Trustee Of
The Charitable Trusts
Burbank, California

Name and employer identification number of estate or trust and name and address (including ZIP code) of fiduciary

Estate Of Walter E. Disney 95-6145544
c/o United California Bank, Co-Executor
600 South Spring Street
Los Angeles, California 90054

FORM **1041**
U.S. Treasury Department
Internal Revenue Service

U.S. Fiduciary Income Tax Return

for the year January 1–December 31, 1968, or other taxable year

beginning _____, 1968, ending _____, 19__

PLEASE PRINT OR TYPE

F 7465-3

1968

Check whether:
- [x] Estate
- [ ] Simple trust
- [ ] Complex trust

If trust, check whether:
- [ ] Testamentary
- [ ] Inter vivos

Name of estate or trust: Walter E. Disney 1-32-1903-0

Employer Identification Number: 95-6145544

Name and title of fiduciary: United California Bank - Co-Executor

Address of fiduciary (number and street): 600 South Spring Street

City, State, and ZIP code: Los Angeles, California 90054

Simple trusts are not required to fill in Schedules B and C.

INCOME	1 Dividends (Enter full amount before exclusion)	69,042.10	
	2 Interest	215,064.32	
	3 Income from partnerships and other fiduciaries		
	4 Gross rents and royalties	4.50	
	5 Gross profit (loss) from trade or business		
	6 Net gain (loss) from capital assets (line 12, column 3, Schedule D, Form 1041)	1,187,172.24	x
	7 Net gain (loss) from property other than capital assets (line 24, Schedule D, Form 1041)		
	8 Other income (State nature of income)		
	9 Total income (lines 1 to 8, inclusive)		1,471,283.16 x
DEDUCTIONS	10 Interest	16,326.16	
	11 Taxes	13,827.29	
	12 Fiduciary's portion of depreciation (Schedule A) and depletion. Explain depletion		
	13 Charitable deduction (line 9, Schedule B)	381,394.61	x
	14 Other deductions (itemize)		
	15 Total (lines 10 to 14, inclusive)		411,548.06 x
	16 Line 9 minus line 15 (Complex trusts and estates enter this amount on line 1 in Schedule C also)		1,059,735.10 x
COMPUTATION OF TAX	17 Deduction for distributions to beneficiaries	139,676.61	
	18 Adjustment of dividend exclusion		
	19 Federal estate tax attributable to income in respect of a decedent (Fiduciary's share		
	20 Long-term capital gain deduction. Enter 50% of line 13(e), Schedule D, Form 1041	593,586.12	x
	21 Exemption	600.00	
	22 Total (lines 17 to 21, inclusive)		733,862.73 x
	23 Taxable income of fiduciary (line 16 minus line 22)		325,872.37 x
	24 Tax on amount on line 23 (See tax rate schedule)		213,600.66 x
	25 If alternative tax is applicable, enter the tax from line 22, Schedule D, Form 1041		163,236.18 x
	26 Tax surcharge (See instruction 26)		12,242.71 x
	27 Total (line 24 or line 25, whichever is applicable, and line 26)		175,478.89 x
	28 Fiduciary's share of foreign tax credit (Attach Form 1116)		
	29 Fiduciary's share of investment credit (Attach Form 3468)		
	30 Total (lines 28 and 29)		
	31 Balance (line 27 less line 30)		175,478.89 x
	32 Tax from recomputing fiduciary's share of prior year investment credit (Attach statement)		
	33 Total (lines 31 and 32)		175,478.89 x
	34 Fiduciary's share of credit for tax paid at source on tax-free covenant bond interest		
	35 Credit for nonhighway Federal gasoline tax and lubricating oil (Attach Form 4136)		
	36 Credit for regulated investment companies (Attach Form 2439)		
	37 Tax previously paid or withheld (Attach explanation)		
	38 Total (lines 34 to 37, inclusive)		
	39 Balance of tax due (line 33 less line 38)		175,478.89
	40 Overpayment (line 38 less line 33)		

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief it is true, correct, and complete. If prepared by a person other than taxpayer, his declaration is based on all information of which he has any knowledge.

Sign here ▶ _____ (Signature of fiduciary or officer representing fiduciary) _____ (Date)

▶ _____ (Signature of preparer other than fiduciary) _____ (Address) _____ (Date)

☆☆☆☆ U.S. GOVERNMENT PRINTING OFFICE : 1968—O-290-018

2/12/69

Schedule A.—DEPRECIATION— Taxpayers using Revenue Procedures 62-21 and 65-13: Make no entry in column 2, enter the cost or other basis of assets held at end of year in column 3, and enter the accumulated depreciation at end of year in column 4.

1. Group and guideline class or description of property	2. Date acquired	3. Cost or other basis	4. Depreciation allowed or allowable in prior years	5. Method of computing depreciation	6. Life or rate	7. Depreciation for this year
1 Total additional first-year depreciation—estates only (do not include in items below) ▶						
2 Totals						
3 Less amount of depreciation claimed elsewhere on return						
4 Balance (line 2 less line 3)						
5 Fiduciary's portion of line 4. Enter here and on line 12, page 1						

Schedule B.—CHARITABLE DEDUCTION— (Attach statement giving name and address of charitable organization.)

1 Amounts paid or permanently set aside for charitable purposes from current year's income		114,280.86
2 Tax-exempt interest allocable to charitable distribution		
(Complete lines 3 and 4 below only if gain on line 11, column 2, Schedule D, Form 1041, exceeds loss on line 10, column 2, Schedule D, Form 1041)		
3 (a) Long-term capital gain included on line 1		
(Do not complete lines (b) and (c) if such amounts are greater than line (a))		
(b) Enter gain on line 11, column 2, Schedule D, Form 1041, minus loss on line 10, column 2, Schedule D, Form 1041		
(c) Enter gain on line 11, column 3, Schedule D, Form 1041, minus loss on line 10, column 3, Schedule D, Form 1041		
4 Enter 50% of the smallest of line 3(a), line 3(b), or line 3(c)		
5 Enter sum of line 2 and line 4		
6 Balance (line 1 minus line 5)		114,280.86
7 Enter short-term capital gains and 50% of the long-term capital gains of the current taxable year allocable to corpus, paid or permanently set aside for charitable purposes		267,113.75 x
8 Amounts paid or permanently set aside for charitable purposes other than from income of the current year		
9 Total (line 6 plus lines 7 and 8). Enter here and on line 13, page 1		381,394.61 x

Schedule C.—DISTRIBUTABLE NET INCOME AND DISTRIBUTIONS DEDUCTION

1 Enter amount from line 16, page 1	1,059,735.10 x
2 Add: (a) Tax-exempt interest (as adjusted)	-0-
(b) Net gain shown on line 12, column 1, Schedule D, Form 1041. If net loss, enter zero	-0-
(c) Lines 4 and 7, Schedule B	267,113.75 x
(d) Short-term capital gain included on line 1, Schedule B	-0-
(e) If amount on line 6, page 1, is a loss, enter amount here	-0-
3 Total (line 1 through line 2(e))	1,326,848.85 x
4 If amount on line 6, page 1, is a gain, enter amount here	1,187,172.24 x
5 Distributable net income (line 3 minus line 4)	139,676.61
6 Amount of income required to be distributed currently	139,676.61
7 Other amounts paid, credited, or otherwise required to be distributed	8,622,155.00
8 Total (lines 6 and 7)	8,761,831.61
9 Enter the total of tax-exempt income included on lines 6 and 7	-0-
10 Balance (line 8 minus line 9)	8,761,831.61
11 Enter distributable net income (line 5, above)	139,676.61
12 Enter the amount from line 2(a), above	-0-
13 Balance (line 11 minus line 12)	139,676.61
14 Distributions deduction. Enter here and on line 17, page 1, the lesser of line 10 or line 13 above	139,676.61

1 Date trust was created or, if an estate, date of decedent's death. December 15, 1966

2 If return is for an estate, has a United States Estate Tax Return been filed? [x] Yes [ ] No. If "No," will return be filed? [ ] Yes [ ] No [ ] Uncertain.

3 If you had tax-exempt income, have you deducted only that portion of expenses allocable to taxable income? [ ] Yes [ ] No.

4 Has final distribution of assets been made during the year? [ ] Yes [x] No.

5 If the estate or trust received income from a nominee, state name, employer identification number, and address of nominee.

☆☆☆☆ U.S. GOVERNMENT PRINTING OFFICE : 1968—O-290-018

SCHEDULE D (Form 1041)
U.S. Treasury Department
Internal Revenue Service

Gains and Losses From Sales or Exchanges of Property

1968

Name of estate or trust: Walter E. Disney, 1-32-1903-0

Part I—CAPITAL ASSETS—Short-Term Capital Gains and Losses—Assets Held Not More Than 6 Months

a. Kind of property (If necessary, attach statement of descriptive details not shown below)	b. Date acquired (mo., day, yr.)	c. Date sold (mo., day, yr.)	d. Gross sales price	e. Depreciation allowed (or allowable) since acquisition	f. Cost or other basis, plus or minus adjustments (if not purchased, attach explanation) and expense of sale	g. Gain or loss (d plus e less f)
1						

2 Enter your share of net short-term gain (or loss) from partnerships and other fiduciaries . . . . .
3 Enter unused short-term capital loss carryover from preceding taxable years (attach statement) . . . . .
4 Net short-term gain (or loss) from lines 1, 2, and 3. Enter here and on line 10 below . . . . .

Long-Term Capital Gains and Losses—Assets Held More Than 6 Months

5						
See Attached Schedule						1,187,172.24 ✓

6 Enter the full amount of your share of net long-term gain (or loss) from partnerships, other fiduciaries, etc. . . . .
7 Enter unused long-term capital loss carryover from preceding taxable years (attach statement) . . . . .
8 Capital gain dividends . . . . .
9 Net long-term gain (or loss) from lines 5, 6, 7, and 8. Enter here and on line 11 below . . . . . 1,187,172.24 ✓

CAPITAL GAINS AND LOSSES

	1. Beneficiaries	2. Fiduciary	3. Total
10 Net short-term gain or loss from line 4, above			
11 Net long-term gain or loss from line 9, above	✓	1,187,172.24	1,187,172.24 ✓
12 Total net gain or loss	✗	1,187,172.24	1,187,172.24 ✗

Enter on line 6, page 1, Form 1041, the net gain shown on line 12, column 3, above. If net loss on line 12, column 3, above, enter as loss on line 6, page 1, Form 1041, whichever of the following is the smallest amount: (i) the amount of the loss, (ii) taxable income computed without regard to capital gains and losses and the deduction for exemption, or (iii) $1,000.

COMPUTATION OF FIDUCIARY'S CAPITAL GAINS DEDUCTION

13(a) Long-term capital gain shown on line 11, column 3, above	1,187,172.24 ✓
(b) Short-term capital loss shown on line 10, column 3, above	-0-
(c) Excess of line 13(a) over line 13(b), above	1,187,172.24 ✓
(d) Long-term capital gains taxable to beneficiaries	-0-
(e) Balance (line 13(c) minus line 13(d)). (Enter 50% of this amount on line 20, page 1, Form 1041.)	1,187,172.24 ✓

Part II—GAIN FROM DISPOSITION OF DEPRECIABLE PROPERTY UNDER SECTIONS 1245 AND 1250—Assets Held More Than 6 Months—Where double headings appear, use the first heading for section 1245 and the second heading for section 1250.

a. Kind of property (If necessary, attach statement of descriptive details not shown below—write 1245 or 1250 to indicate type of asset)	b. Date acquired (mo., day, yr.)	c. Date sold (mo., day, yr.)	d. Gross sales price	e. Cost or other basis, cost of subsequent improvements (if not purchased, attach explanation) and expense of sale
14				

f. Depreciation allowed (or allowable) since acquisition		g. Adjusted basis (e less sum of f-1 and f-2)	h. Total gain (d less g)	i. Ordinary gain (lesser of f-2 or h) — OR — (see instructions)	j. Other gain (h less i)
f-1. Prior to January 1, 1962 — OR — Prior to January 1, 1964	f-2. After December 31, 1961 — OR — After December 31, 1963				

15 Total ordinary gain. Enter here and in column g, line 23, Part III . . . . .
16 Total other gain. Enter here and in column g, line 5, Part I; however, if the gains do not exceed the losses when this amount is combined with other gains and losses from section 1231 property, enter the total of column j in column g, line 23, Part III . . . . .

18—00512-1

COMPUTATION OF ALTERNATIVE TAX

If fiduciary had a net long-term capital gain or an excess of net long-term capital gain over net short-term capital loss shown in column 2, line 12, and line 23, page 1, Form 1041, exceeds $26,000, it may be to his advantage to make the alternative tax computation.

17 Amount from line 23, page 1, Form 1041	325,872.37 ✓
18 50% of amount on line 13(e) . 50% (1,187,172.24 - 534,227.51)	326,472.36 ✓
19 Balance (line 17 minus line 18)	-0-
20 Tax on amount on line 19 (see tax rate schedule)	-0-
21 50% of amount on line 19, above	163,236.18 ✓
22 Alternative tax (line 20 plus line 21); if less than line 24, page 1, Form 1041, enter this amount on line 25, page 1, Form 1041	163,236.18 ✓

Part III—PROPERTY OTHER THAN CAPITAL ASSETS

a. Kind of property (If necessary, attach statement of descriptive details not shown below)	b. Date acquired (mo., day, yr.)	c. Date sold (mo., day, yr.)	d. Gross sales price	e. Depreciation allowed (or allowable) since acquisition	f. Cost or other basis, plus or minus adjustments (if not purchased, attach explanation) and expense of sale	g. Gain or loss (d plus e less f)
23						
24 Net gain (or loss). Enter here and on line 7, page 1, Form 1041						

INSTRUCTIONS
(References are to the Internal Revenue Code)

Gains and losses from sales and exchanges of capital assets and other property.—In computing gross income no distinction is made between gains and losses allocable to income account and those allocable to corpus account.

"Capital assets" defined.—The term "capital assets" means property held by the estate or trust (whether or not connected with the trade or business) but does NOT include—

(*a*) stock in trade or other property of a kind properly includible in inventory if on hand at the close of the taxable year;

(*b*) property held by the taxpayer primarily for sale to customers in the ordinary course of trade or business;

(*c*) property used in the trade or business of a character which is subject to the allowance for depreciation provided in section 167;

(*d*) real property used in the trade or business of the taxpayer;

(*e*) certain government obligations issued on or after March 1, 1941, at a discount, payable without interest and maturing at a fixed date not exceeding one year from date of issue;

(*f*) certain copyrights, literary, musical, or artistic compositions, etc.; or

(*g*) accounts and notes receivable acquired in the ordinary course of trade or business for services rendered or from the sale of property referred to in (*a*) or (*b*) above.

Gains and losses from transactions described in section 1231 (see below) shall be treated as gains and losses from the sale or exchange of capital assets held for more than 6 months if the total of these gains exceeds the total of these losses. If the total of these gains does not exceed the total of these losses, such gains and losses shall not be treated as gains and losses from the sale or exchange of capital assets. Thus, in the event of a net gain, all these transactions should be entered in the "long-term capital gains and losses" portion of Schedule D. In the event of a net loss, all these transactions should be entered in the "property other than capital assets" portion of Schedule D, or in other applicable schedules on Form 1041.

Section 1231 deals with gains and losses arising from—

(*a*) sale, exchange, or involuntary conversion, of land (including in certain cases unharvested crops sold with the land) and depreciable property if they are used in the trade or business and held for more than 6 months,

(*b*) sale, exchange, or involuntary conversion of livestock (but not including poultry) held for draft, breeding, or dairy purposes and held for 1 year or more,

(*c*) the cutting of timber or the disposal of timber, coal, or domestic iron ore to which section 631 applies, and

(*d*) the involuntary conversion of capital assets held more than 6 months.

See sections 1231 and 631 for specific conditions applicable.

Gain from disposition of depreciable property under sections 1245 and 1250—Assets held more than 6 months (Part II).—(Report any gain from such property held for 6 months or less in Part III.) Except as provided below, section 1245 property means depreciable (*a*) personal property (other than livestock) including intangible personal property; and (*b*) tangible real property (except for buildings and their structural components) if used as an integral part of manufacturing, production, or extraction, or of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services, or used as a research or storage facility in connection with these activities; and (*c*) elevators and escalators.

Except as provided below, section 1250 property means depreciable real property (other than section 1245 property).

See sections 1245 (b) and 1250 (d) for exceptions and limitations involving: (*a*) disposition by gift; (*b*) transfers at death; (*c*) certain tax-free transactions; (*d*) like kind exchanges, involuntary conversions; (*e*) sales or exchanges to effectuate FCC policies and exchanges to comply with S.E.C. orders; (*f*) property distributed by a partnership to a partner; and (*g*) disposition of principal residence (section 1250 only).

Column f of Part II.—In computing depreciation allowed or allowable for elevators or escalators, enter in column *f*-1 depreciation prior to July 1, 1963, and in column *f*-2 depreciation after June 30, 1963.

Column i of Part II, section 1250 property only.—If held for more than 6 months, but not more than 1 year, enter the smaller of (1) column h, or (2) column *f*-2. If held for more than 1 year, enter the result of multiplying the smaller of (1) column h, or (2) column *f*-2 less the amount of depreciation computed for the same period using the straight line method, by the percentage obtained by subtracting from 100%, one percentage point for each full month the property was held in excess of 20 months. Where substantial improvements have been made within the preceding 10 years, see section 1250 (f).

(Instructions continued on reverse of duplicate)

18—00512-1 470

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Supplemental Stipulation of Facts

United States District Court, Central District of California.

UNITED CALIFORNIA BANK and LILLIAN DISNEY TRUYENS, Co-Executors of the Estate of Walter E. Disney, Plaintiffs, v. UNITED STATES OF AMERICA, Defendant. No. 73-2828-IH CIVIL.

Filed: Jul 9, 1974.

On June 28, 1974, the parties in this matter filed their Stipulation of Facts and Question of Law. Inadvertently, the Fiduciary Income Tax Return for the Estate for the taxable year 1968, referred to in paragraph 6 and attached as Exhibit C, is the one originally filed. It was intended that the reference be made to the *amended* 1968 return which is attached to this Supplemental Stipulation of Facts as Exhibit D.

DATED: July 3, 1974.

GIBSON, DUNN & CRUTCHER
/s/ Marc R. Isaacson
MARC R. ISAACSON
Attorneys for Plaintiffs
WILLIAM D. KELLER
United States Attorney
CHARLES H. MAGNUSON
Assistant United States Attorney
Chief, Tax Division
MASON C. LEWIS
Assistant United States Attorney
/s/ Mason C. Lewis
MASON C. LEWIS
Attorneys for United States of America

EXHIBIT D.

FORM **1041**
U.S. Treasury Department
Internal Revenue Service

U.S. Fiduciary Income Tax Return

for the year January 1–December 31, 1968, or other taxable year

1968

beginning ..... 1968, ending ..... 19....

PLEASE PRINT OR TYPE

Check whether:
- [X] Estate
- [ ] Simple trust
- [ ] Complex trust

If trust, check whether:
- [ ] Testamentary
- [ ] Inter vivos

Name of estate or trust: Walter E. Disney (1-32-1903-0)

Employer Identification Number: 95-6145544

Name and title of fiduciary: United California Bank - Co-Executor

Address of fiduciary (number and street): 600 South Spring Street

City, State, and ZIP code: Los Angeles, California 90054

Simple trusts are not required to fill in Schedules B and C.

INCOME	1 Dividends (Enter full amount before exclusion)	69,042.10	
	2 Interest	215,064.32	
	3 Income from partnerships and other fiduciaries		
	4 Gross rents and royalties	4.50	
	5 Gross profit (loss) from trade or business		
	6 Net gain (loss) from capital assets (line 12, column 3, Schedule D, Form 1041)	1,058,018.43	
	7 Net gain (loss) from property other than capital assets (line 24, Schedule D, Form 1041)		
	8 Other income (State nature of income)		
	9 Total income (lines 1 to 8, inclusive)		1,342,129.35
DEDUCTIONS	10 Interest	16,326.16	
	11 Taxes	13,827.29	
	12 Fiduciary's portion of depreciation (Schedule A) and depletion. Explain depletion		
	13 Charitable deduction (line 9, Schedule B)	352,335.01	
	14 Other deductions (itemize)		
	15 Total (lines 10 to 14, inclusive)		382,488.46
	16 Line 9 minus line 15 (Complex trusts and estates enter this amount on line 1 in Schedule C also)		959,640.89
	17 Deduction for distributions to beneficiaries	139,676.61	
	18 Adjustment of dividend exclusion		
	19 Federal estate tax attributable to income in respect of a decedent (Fiduciary's share)		
	20 Long-term capital gain deduction. Enter 50% of line 13(e), Schedule D, Form 1041	529,009.21	
	21 Exemption	600.00	
	22 Total (lines 17 to 21, inclusive)		669,285.82
	23 Taxable income of fiduciary (line 16 minus line 22)		290,355.07
COMPUTATION OF TAX	24 Tax on amount on line 23 (See tax rate schedule)		188,738.55
	25 If alternative tax is applicable, enter the tax from line 22, Schedule D, Form 1041		145,477.53
	26 Tax surcharge (See instruction 26)		10,910.81
	27 Total (line 24 or line 25, whichever is applicable, and line 26)		156,388.34
	28 Fiduciary's share of foreign tax credit (Attach Form 1116)		
	29 Fiduciary's share of investment credit (Attach Form 3468)		
	30 Total (lines 28 and 29)		
	31 Balance (line 27 less line 30)		156,388.34
	32 Tax from recomputing fiduciary's share of prior year investment credit (Attach statement)		
	33 Total (lines 31 and 32)		156,388.34
	34 Fiduciary's share of credit for tax paid at source on tax-free covenant bond interest		
	35 Credit for nonhighway Federal gasoline tax and lubricating oil (Attach Form 4136)		
	36 Credit for regulated investment companies (Attach Form 2439)		
	37 Tax previously paid or withheld (Attach explanation)	175,478.89	
	38 Total (lines 34 to 37, inclusive)		175,478.89
	39 Balance of tax due (line 33 less line 38)		-0-
	40 Overpayment (line 38 less line 33)		19,090.55

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief it is true, correct, and complete. If prepared by a person other than taxpayer, his declaration is based on all information of which he has any knowledge.

Sign here ▶ United California Bank
By:
Lillian B. Disney
Co-Executrix
Signature of fiduciary or officer representing fiduciary — Date

▶ Signature of preparer other than fiduciary — Address — Date

Schedule A.—DEPRECIATION—Taxpayers using Revenue Procedures 62-21 and 65-13: Make no entry in column 2, enter the cost or other basis of assets held at end of year in column 3, and enter the accumulated depreciation at end of year in column 4.

1. Group and guideline class or description of property	2. Date acquired	3. Cost or other basis	4. Depreciation allowed or allowable in prior years	5. Method of computing depreciation	6. Life or rate	7. Depreciation for this year
1 Total additional first-year depreciation—estates only (do not include in items below) ⟶						
2 Totals						
3 Less amount of depreciation claimed elsewhere on return						
4 Balance (line 2 less line 3)						
5 Fiduciary's portion of line 4. Enter here and on line 12, page 1						

Schedule B.—CHARITABLE DEDUCTION— (Attach statement giving name and address of charitable organization.) (See Schedule E)

1 Amounts paid or permanently set aside for charitable purposes from current year's income		114,280.86
2 Tax-exempt interest allocable to charitable distribution		
(Complete lines 3 and 4 below only if gain on line 11, column 2, Schedule D, Form 1041, exceeds loss on line 10, column 2, Schedule D, Form 1041)		
3 (a) Long-term capital gain included on line 1 (Do not complete lines (b) and (c) if such amounts are greater than line (a))		
(b) Enter gain on line 11, column 2, Schedule D, Form 1041, minus loss on line 10, column 2, Schedule D, Form 1041		
(c) Enter gain on line 11, column 3, Schedule D, Form 1041, minus loss on line 10, column 3, Schedule D, Form 1041		
4 Enter 50% of the smallest of line 3(a), line 3(b), or line 3(c)		
5 Enter sum of line 2 and line 4		
6 Balance (line 1 minus line 5)		114,280.86
7 Enter short-term capital gains and 50% of the long-term capital gains of the current taxable year allocable to corpus, paid or permanently set aside for charitable purposes		238,054.15
8 Amounts paid or permanently set aside for charitable purposes other than from income of the current year		
9 Total (line 6 plus lines 7 and 8). Enter here and on line 13, page 1		352,335.01

Schedule C.—DISTRIBUTABLE NET INCOME AND DISTRIBUTIONS DEDUCTION

1 Enter amount from line 16, page 1	959,640.89
2 Add: (a) Tax-exempt interest (as adjusted)	
(b) Net gain shown on line 12, column 1, Schedule D, Form 1041. If net loss, enter zero	238,054.15
(c) Lines 4 and 7, Schedule B	
(d) Short-term capital gain included on line 1, Schedule D	
(e) If amount on line 6, page 1, is a loss, enter amount here	
3 Total (line 1 through line 2(e))	1,197,695.04
4 If amount on line 6, page 1, is a gain, enter amount here	1,058,018.43
5 Distributable net income (line 3 minus line 4)	139,676.61
6 Amount of income required to be distributed currently	139,676.61
7 Other amounts paid, credited, or otherwise required to be distributed	3,622,155.00
8 Total (lines 6 and 7)	3,761,831.61
9 Enter the total of tax-exempt income included on lines 6 and 7	
10 Balance (line 8 minus line 9)	3,761,831.61
11 Enter distributable net income (line 5, above)	139,676.61
12 Enter the amount from line 2(a), above	
13 Balance (line 11 minus line 12)	139,676.61
14 Distributions deduction. Enter here and on line 17, page 1, the lesser of line 10 or line 13 above	139,676.61

1 Date trust was created or, if an estate, date of decedent's death. December 15, 1966

2 If return is for an estate, has a United States Estate Tax Return been filed? [X] Yes [ ] No. If "No," will return be filed? [ ] Yes [ ] No [ ] Uncertain.

3 If you had tax-exempt income, have you deducted only that portion of expenses allocable to taxable income? [ ] Yes [ ] No.

4 Has final distribution of assets been made during the year? [ ] Yes [X] No.

5 If the estate or trust received income from a nominee, state name, employer identification number, and address of nominee.

16—50221-1 ☆☆☆ U.S. GOVERNMENT PRINTING OFFICE : 1968 —O 290-018

WR-A-4201-GPO

"AMENDED RETURN"

SCHEDULE D (Form 1041)
U.S. Treasury Department
Internal Revenue Service

Gains and Losses From Sales or Exchanges of Property

1968

Name of estate or trust
Walter E. Disney (1-32-1903-0)

Part I—CAPITAL ASSETS—Short-Term Capital Gains and Losses—Assets Held Not More Than 6 Months

a. Kind of property (if necessary, attach statement of descriptive details not shown below)	b. Date acquired (mo., day, yr.)	c. Date sold (mo., day, yr.)	d. Gross sales price	e. Depreciation allowed (or allowable) since acquisition	f. Cost or other basis, cost of subsequent improvements (if not purchased, attach explanation) and expense of sale	g. Gain or loss (d plus e less f)
1						

2 Enter your share of net short-term gain (or loss) from partnerships and other fiduciaries . . . . . .
3 Enter unused short-term capital loss carryover from preceding taxable years (attach statement) . . . . . .
4 Net short-term gain (or loss) from lines 1, 2, and 3. Enter here and on line 10 below . . . . . .

Long-Term Capital Gains and Losses—Assets Held More Than 6 Months

5						
	SEE ATTACHED SCHEDULE					1,058,018.43

6 Enter the full amount of your share of net long-term gain (or loss) from partnerships, other fiduciaries, etc. . . . . .
7 Enter unused long-term capital loss carryover from preceding taxable years (attach statement) . . . . . .
8 Capital gain dividends . . . . . .
9 Net long-term gain (or loss) from lines 5, 6, 7, and 8. Enter here and on line 11 below 1,058,018.43

CAPITAL GAINS AND LOSSES

	1. Beneficiaries	2. Fiduciary	3. Total
10 Net short-term gain or loss from line 4, above			
11 Net long-term gain or loss from line 9, above	%	1,058,018.43	1,058,018.43
12 Total net gain or loss	%	1,058,018.43	1,058,018.43

Enter on line 6, page 1, Form 1041, the net gain shown on line 12, column 3, above. If net loss on line 12, column 3, above, enter as loss on line 6, page 1, Form 1041, whichever of the following is the smallest amount: (i) the amount of the loss, (ii) taxable income computed without regard to capital gains and losses and the deduction for exemption, or (iii) $1,000.

COMPUTATION OF FIDUCIARY'S CAPITAL GAINS DEDUCTION

13(a) Long-term capital gain shown on line 11, column 3, above	1,058,018.43
(b) Short-term capital loss shown on line 10, column 3, above	-0-
(c) Excess of line 13(a) over line 13(b), above	1,058,018.43
(d) Long-term capital gains taxable to beneficiaries	-0-
(e) Balance (line 13(c) minus line 13(d)). (Enter 50% of this amount on line 20, page 1, Form 1041.)	1,058,018.43

Part II—GAIN FROM DISPOSITION OF DEPRECIABLE PROPERTY UNDER SECTIONS 1245 AND 1250—Assets Held More Than 6 Months—Where double headings appear, use the first heading for section 1245 and the second heading for section 1250.

a. Kind of property (if necessary, attach statement of descriptive details not shown below—write 1245 or 1250 to indicate type of asset)	b. Date acquired (mo., day, yr.)	c. Date sold (mo., day, yr.)	d. Gross sales price	e. Cost or other basis, cost of subsequent improvements (if not purchased, attach explanation) and expense of sale
14				

f. Depreciation allowed (or allowable) since acquisition		g. Adjusted basis (e less sum of f-1 and f-2)	h. Total gain (d less g)	i. Ordinary gain (lesser of f-2 or h) — OR — (see instructions)	j. Other gain (h less i)
f-1. Prior to January 1, 1962 — OR — Prior to January 1, 1964	f-2. After December 31, 1961 — OR — After December 31, 1963				

15 Total ordinary gain. Enter here and in column g, line 23, Part III . . . . . .
16 Total other gain. Enter here and in column g, line 5, Part I; however, if the gains do not exceed the losses when this amount is combined with other gains and losses from section 1231 property, enter the total of column j in column g, line 23, Part III . . . . . .

16—80215-1

COMPUTATION OF ALTERNATIVE TAX

If fiduciary had a net long-term capital gain or an excess of net long-term capital gain over net short-term capital loss shown in column 2, line 12, and line 23, page 1, Form 1041, exceeds $26,000, it may be to his advantage to make the alternative tax computation.

17 Amount from line 23, page 1, Form 1041	290,355.07
18 50% of amount on line 13(e)	290,955.07
19 Balance (line 17 minus line 18)	-0-
20 Tax on amount on line 19 (see tax rate schedule)	-0-
21 50% of amount on line 18, above	145,477.53
22 Alternative tax (line 20 plus line 21); if less than line 24, page 1, Form 1041, enter this amount on line 25, page 1, Form 1041	145,477.53

Part III—PROPERTY OTHER THAN CAPITAL ASSETS

a. Kind of property (if necessary, attach statement of descriptive details not shown below)	b. Date acquired (mo., day, yr.)	c. Date sold (mo., day, yr.)	d. Gross sales price	e. Depreciation allowed (or allowable) since acquisition	f. Cost or other basis, cost of subsequent improvements (if not purchased, attach explanation) and expense of sale	g. Gain or loss (d plus e less f)
23						

24 Net gain (or loss). Enter here and on line 7, page 1, Form 1041 . . . . . .

INSTRUCTIONS
(References are to the Internal Revenue Code)

Gains and losses from sales and exchanges of capital assets and other property.—In computing gross income no distinction is made between gains and losses allocable to income account and those allocable to corpus account.

"Capital assets" defined.—The term "capital assets" means property held by the estate or trust (whether or not connected with the trade or business) but does NOT include—

(*a*) stock in trade or other property of a kind properly includible in inventory if on hand at the close of the taxable year;

(*b*) property held by the taxpayer primarily for sale to customers in the ordinary course of trade or business;

(*c*) property used in the trade or business of a character which is subject to the allowance for depreciation provided in section 167;

(*d*) real property used in the trade or business of the taxpayer;

(*e*) certain government obligations issued on or after March 1, 1941, at a discount, payable without interest and maturing at a fixed date not exceeding one year from date of issue;

(*f*) certain copyrights, literary, musical, or artistic compositions, etc.; or

(*g*) accounts and notes receivable acquired in the ordinary course of trade or business for services rendered or from the sale of property referred to in (*a*) or (*b*) above.

Gains and losses from transactions described in section 1231 (see below) shall be treated as gains and losses from the sale or exchange of capital assets held for more than 6 months if the total of these gains exceeds the total of these losses. If the total of these gains does not exceed the total of these losses, such gains and losses shall not be treated as gains and losses from the sale or exchange of capital assets. Thus, in the event of a net gain, all these transactions should be entered in the "long-term capital gains and losses" portion of Schedule D. In the event of a net loss, all these transactions should be entered in the "property other than capital assets" portion of Schedule D, or in other applicable schedules on Form 1041.

Section 1231 deals with gains and losses arising from—

(*a*) sale, exchange, or involuntary conversion, of land (including in certain cases unharvested crops sold with the land) and depreciable property if they are used in the trade or business and held for more than 6 months,

(*b*) sale, exchange, or involuntary conversion of livestock (but not including poultry) held for draft, breeding, or dairy purposes and held for 1 year or more,

(*c*) the cutting of timber or the disposal of timber, coal, or domestic iron ore to which section 631 applies, and

(*d*) the involuntary conversion of capital assets held more than 6 months.

See sections 1231 and 631 for specific conditions applicable.

Gain from disposition of depreciable property under sections 1245 and 1250—Assets held more than 6 months (Part II).—(Report any gain from such property held for 6 months or less in Part III.) Except as provided below, section 1245 property means depreciable (*a*) personal property (other than livestock) including intangible personal property; and (*b*) tangible real property (except for buildings and their structural components) if used as an integral part of manufacturing, production, or extraction, or of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services, or used as a research or storage facility in connection with these activities; and (*c*) elevators and escalators.

Except as provided below, section 1250 property means depreciable real property (other than section 1245 property).

See sections 1245 (b) and 1250 (d) for exceptions and limitations involving: (*a*) disposition by gift; (*b*) transfers at death; (*c*) certain tax-free transactions; (*d*) like kind exchanges, involuntary conversions; (*e*) sales or exchanges to effectuate FCC policies and exchanges to comply with S.E.C. orders; (*f*) property distributed by a partnership to a partner; and (*g*) disposition of principal residence (section 1250 only).

Column f of Part II.—In computing depreciation allowed or allowable for elevators or escalators, enter in column f-1 depreciation prior to July 1, 1963, and in column f-2 depreciation after June 30, 1963.

Column i of Part II, section 1250 property only.—If held for more than 6 months, but not more than 1 year, enter the smaller of (1) column h, or (2) column f-2. If held for more than 1 year, enter the result of multiplying the smaller of (1) column h, or (2) column f-2 less the amount of depreciation computed for the same period using the straight line method, by the percentage obtained by subtracting from 100%, one percentage point for each full month the property was held in excess of 20 months. Where substantial improvements have been made within the preceding 10 years, see section 1250 (f).

(Instructions continued on reverse of duplicate)

16—80215-1 GPO

☆☆☆☆ U.S. GOVERNMENT PRINTING OFFICE: 1968—O-290-108

ACCOUNT Walter E. Disney NO. 1-32-1903-1

UNITED CALIFORNIA BANK
600 SOUTH SPRING STREET
LOS ANGELES, CALIFORNIA 90054

AMENDED RETURN
SCHEDULE OF CAPITAL GAINS AND LOSSES

YEAR 1968

DESCRIPTION OF PROPERTY	DATE ACQUIRED	DATE SOLD	AMOUNT REALIZED	COST	FEDERAL RETURN		STATE RETURN	
					SHORT-TERM GAIN OR LOSS	LONG-TERM GAIN OR LOSS	SHORT-TERM GAIN OR LOSS	LONG-TERM GAIN OR LOSS
700 Shares Walter E. Disney Productions	12-15-66	1-2-68	39,351.47	20,415.53		18,935.94		
7100 Shares Walter E. Disney Productions	12-15-66	1-3-68	397,554.08	207,071.78		190,482.30		
1900 Shares Walter E. Disney Productions	12-15-66	1-4-68	106,529.28	55,413.58		51,115.70		
400 Shares Walter E. Disney Productions	12-15-66	1-5-68	22,201.15	11,666.02		10,535.13		
200 Shares Walter E. Disney Productions	12-15-66	1-8-68	11,100.57	5,833.01		5,267.56		
1200 Shares Walter E. Disney Productions	12-15-66	1-30-68	69,175.79	34,998.05		34,177.74		
2200 Shares Walter E. Disney Productions	12-15-66	1-31-68	127,113.71	64,163.09		62,950.62		
1800 Shares Walter E. Disney Productions	12-15-66	2-1-68	104,063.36	52,497.07		51,566.29		
1100 Shares Walter E. Disney Productions	12-15-66	2-7-68	63,500.61	32,031.54		31,419.07		
22,000 Shares Walter E. Disney Productions	12-15-66	5-17-68	1243,190.74	641,530.88		601,559.86		
Account Number: 1-32-1903-3								
-14 Shares Walter E. Disney Productions	12-15-66	2-29-68	8.22	-0-		8.22		
TOTALS			2183,788.98	1125,770.55		1058,018.43		
NET LONG-TERM AND SHORT-TERM GAIN OR LOSS						1058,018.43		
LESS PORTION TAXABLE TO BENEFICIARIES						-0-		
PORTION TAXABLE TO FIDUCIARY (ENTER TOTAL NET GAIN OR LOSS TO APPROPRIATE SCHEDULE)						1058,018.43		
ENTER HERE AND ON PAGE 1 OF TAX RETURNS 50% OF FIDUCIARY'S L/T GAIN LESS S/T LOSS								

TRUST DEPT. (TAX DIV.) D

Civil Minutes—General.

Case No. 73-2828-IH.

Date: Nov. 7, 1974.

Title: United California Bank, et al. vs. U. S. A.

DOCKET ENTRY

PRESENT:

HON. IRVING HILL, Judge; Florence Kato, Deputy Clerk; Don Cram, Court Reporter.

ATTORNEYS PRESENT FOR PLAINTIFFS:
GIBSON, DUNN & CRUTCHER
Marc R. Isaacson
Ronald Gother

ATTORNEYS PRESENT FOR DEFENDANTS:
Mason C. Lewis
Ass't U. S. Attorney

PROCEEDINGS: COURT TRIAL: Oral arguments
Arguments heard.
Court finds Judgment in favor of Plaintiffs.
Plaintiffs' counsel ordered to prepare Judgment and Findings of Fact etc. to be Lodged with the Court by 11/15/74, and any opposing response in writing by 11/20/74.

Findings of Fact and Conclusions of Law.

United States District Court, for the Central District of California.

United California Bank and Lillian Disney Truyens, Co-Executors of the Estate of Walter E. Disney, Plaintiffs, v. United States of America, Defendant. No. 73 2828 IH.

Filed December 2, 1974.

The within action came on for trial upon stipulated facts before the above-entitled Court, the Honorable Irving Hill, United States District Judge presiding, and the parties having appeared by their respective counsel and having submitted written and oral argument, the Court makes the following findings of fact and conclusions of law.

Findings of Fact

1. The Court finds that the facts are as set forth in the Stipulation of Facts and Question of Law and in the Supplemental Stipulation of Facts, on file in this proceeding, and incorporates said facts by reference as though the same were herein set forth in full.

2. All findings of fact set forth under the heading "Conclusions of Law" are incorporated herein by reference as though the same were herein set forth in full.

Conclusions of Law

1. All conclusions of law appearing under the heading "Findings of Fact" are incorporated herein by reference as though the same were herein set forth in full.

2. The Court has jurisdiction over the parties and over the subject matter of this action.

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3. Venue properly lies in this Court.

4. The case of *Statler Trust v. C.I.R.* (2d Cir., (1966), 361 F.2d 128, involved identical questions of law in the interpretation of Internal Revenue Code § 642(c) and § 1201(b) and substantially similar facts to those presented in the present case. The majority opinion of the Court in *Statler Trust v. C.I.R.* correctly interpreted and applied Internal Revenue Code § 642(c) and § 1201(b). A similar interpretation of the law and its application in the present case entitles Plaintiffs to judgment as a matter of law.

5. Congress has implicitly acquiesced in and confirmed the Second Circuit Court of Appeals' decision in *Statler Trust v. C.I.R.* (2d Cir., 1966), 361 F.2d 128, by its subsequently amending the several statutory provisions construed therein without overruling said construction and without altering the statutory language pertinent to said construction.

6. Any amounts which may be deducted in the computation of the taxable income of an estate or trust under Internal Revenue Code § 642(c) as amounts which pursuant to the terms of the governing instrument are permanently set aside for a charitable purpose or use as described in § 642(c)(2) may be excluded by said estate or trust from "the excess of the net long-term capital gain over the net short-term capital loss" in computing the alternative tax under § 1201(b).

7. Defendant erred in disallowing Plaintiffs' exclusion from the excess of the net long-term capital gain over the net short-term capital loss under § 1201(b) of the 45% thereof which, pursuant to the terms of the decedent's Will, was set aside to the Disney Foundation for a charitable purpose or use.

8. Plaintiffs are entitled to judgment as prayed for in the Complaint as a matter of law.

Dated: December 2, 1974.

/s/ Irving Hill
Irving Hill
United States District Judge

APPROVED AS TO FORM:

WILLIAM D. KELLER
United States Attorney

CHARLES H. MAGNUSON
Assistant United States Attorney
Chief, Tax Division

MASON C. LEWIS
Assistant United States Attorney

/s/ Mason C. Lewis
MASON C. LEWIS
Attorneys for United States of America

Judgment.

United States District Court, for the Central District of California.

United California Bank and Lillian Disney Truyens, Co-Executors of the Estate of Walter E. Disney, Plaintiffs, v. United States of America, Defendant. No. 73 2828 IH.

Filed: December 2, 1974.

The within action having come on for trial upon stipulated facts before the above-entitled Court, the Honorable Irving Hill, United States District Judge presiding, and the Court having found in accordance with the findings of fact and conclusions of law entered in this action that the Plaintiffs are entitled as a matter of law to judgment as prayed for in the Complaint, the Court hereby orders that judgment be entered for the Plaintiffs and against the Defendant, as follows:

IT IS HEREBY ORDERED, ADJUDGED AND DECREED that United California Bank and Lillian Disney Truyens, Co-Executors of the Estate of Walter E. Disney, have judgment against the United States of America in the amount of $85,795.20 plus $10.488 for each day from November 22, 1974 to the date of entry of judgment, with interest to accrue on the amount of judgment, from and after the date of entry of judgment, at the rates and for the periods prescribed by law.

DATED: December 2, 1974.

/s/ Irving Hill
Irving Hill
United States District Judge

SUPREME COURT OF THE UNITED STATES

No. 77-1016

United California Bank and Lillian Disney Truyens, Co-Executors of the Estate of Walter E. Disney,

Petitioners,

v.

United States

Order allowing Certiorari. Filed March 20, 1978.

The petition herein for a writ of certiorari to the United States Court of Appeals for the Ninth Circuit is granted.

Supreme Court, U. S.
FILED
FEB 28 1978
MICHAEL RODAK, JR., CLERK

No. 77-1016

In the Supreme Court of the United States

OCTOBER TERM, 1977

UNITED CALIFORNIA BANK and LILLIAN DISNEY TRUYENS, CO-EXECUTORS OF THE ESTATE OF WALTER E. DISNEY, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

WADE H. MCCREE, JR.,
Solicitor General,
Department of Justice,
Washington, D.C. 20530.

In the Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-1016

UNITED CALIFORNIA BANK and LILLIAN DISNEY TRUYENS, CO-EXECUTORS OF THE ESTATE OF WALTER E. DISNEY, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

The question presented in this federal income tax case involves the proper computation of an estate's tax on its capital gains. By the terms of his will, Walter E. Disney left 45 percent of the residue of his estate to the Disney Foundation and the California Institute of the Arts, both of which are tax-exempt charitable organizations. During 1967 and 1968, petitioners, as co-executors of the estate, sold certain securities that were part of the residue of the estate and realized long-term capital gain. In accordance with the will, 45 percent of the gain was set aside for the Disney Foundation (Pet. 2; Pet. App. 5).

There are two methods of computing the tax on long-term capital gains. Under the so-called "normal" method of Section 1202 of the Internal Revenue Code of 1954 (26 U.S.C.), the taxpayer includes the long-term capital gain in gross income, and then deducts 50 percent of the net long-term capital gains. Section 1201(b) prescribes the "alternative" tax, calculated in two steps and applied when resulting in a lower tax liability than the normal method. The first step computes a partial tax at the ordinary rates on the taxable income reduced by the long-term capital gain. This step effectively subjects only ordinary income to the partial tax. The second step imposes a 25 percent tax on the net long-term capital gain.

The question presented is whether, in computing its tax on capital gains, petitioners were entitled to exclude from the calculation the 45 percent portion set aside for charitable purposes. If it were so entitled, the alternative tax would have been less than the normal tax and therefore applicable.

In computing the estate's income tax for 1967 and 1968, petitioners deducted from its net long-term capital gain the portion that had been permanently set aside for charitable purposes, and then employed the 25 percent alternative tax computation. On audit, the Commissioner of Internal Revenue determined that petitioners could not exclude from the computations the capital gains set aside for the charity, and therefore concluded that the normal rather than the alternative tax was applicable (Pet. App. 5-6). In this refund suit brought by petitioners in the United States District Court for the Central District of California, the district court upheld petitioners' claimed refund on the authority of *Statler Trust* v. *Commissioner*, 361 F. 2d 128 (C.A. 2) (Pet. 5; Pet. App. 6).

The court of appeals reversed. It held that the capital gains tax computations permit no reduction for amounts set aside for charity (Pet. App. 4-15).

1. We agree with petitioners' assertion (Pet. 6-9) tha the decision below conflicts with *Statler Trust* v *Commissioner, supra.* There, a divided panel of th Second Circuit held that in computing its alternativ capital gains tax, a trust could deduct from its long-term capital gains the amount of those gains it was required to set aside for charitable purposes. As a result, the trust became eligible for the Section 1201(b) alternative tax computation.

In so holding, the court rejected the government's argument that there was no statutory basis for such a deduction because the language of Section 1201(b)(2)—which includes "net long-term capital gain" in the 25 percent tax base—means total net long-term capital gain. Although the Second Circuit acknowledged that the language of Section 1201(b) supported the government's position, it concluded that "the letter of § 1201(b) must yield when it would lead to an unfair and unintended result" (361 F. 2d at 131). The court rested its holding that the amounts set aside for charity could be deducted under Section 1201(b) because they fell within the general conduit principles of the taxation of trusts. See Sections 661, 662. In the court's view, the amounts set aside by the trust for charity were to be treated as never having belonged to the trust for tax purposes.

Here, however, the court of appeals expressly disagreed with the conduit analysis of *Statler Trust* (see Pet. App. 15). As the court observed, amounts distributed or set aside to charity are not excluded from the distributable net income of a trust, even when they consist of capital gains. See Section 643(a)(3). Moreover, the system of taxation of trusts does not exclude from income amounts distributed to charity but provides for an unlimited deduction for charitable distributions. See Sections 642(c), 662(a), 663(a)(2). Thus, the Second Circuit's

assumption that the conduit principles permit a trust to exclude net long-term capital gain distributed to a charity in computing the alternative tax erroneously permits a taxpayer to cumulate the benefits of a charitable deduction and the alternative capital gains tax computation.

2. Despite the acknowledged conflict of decisions, we do not believe that the question presented warrants review by this Court at this time. The Internal Revenue Service advises that there are no cases presently pending administratively or in the courts that involve the question. In the last 12 years, *Statler Trust* and this case have been the only decided cases addressing the question.

Moreover, since the Second Circuit's decision in *Statler Trust,* this Court in *United States* v. *Foster Lumber Co.,* 429 U.S. 32, has held in an analogous context that the Internal Revenue Code did not permit the cumulation of the benefits of the loss carryover provisions of Section 172 with the benefits of the alternative capital gains computation of Section 1201. While the computational issue in *Foster Lumber* and this case are not precisely the same, both cases held that the specific language of the Code overrode any argument that the result was contrary to what the taxpayer alleged to be the general congressional policy. Hence, it is not certain that the Second Circuit would adhere to its *Statler Trust* decision if the matter were presented to it again.

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

WADE H. MCCREE, JR.,
Solicitor General.

FEBRUARY 1978.

DOJ-1978-02

Supreme Court, U. S.
FILED
MAR 3 1978
MICHAEL RODAK, JR., CLERK

MAR 17 PAGE 9

IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-1016

UNITED CALIFORNIA BANK and LILLIAN DISNEY TRUYENS, Co-Executors of the Estate of WALTER E. DISNEY, *Petitioners,*

vs.

UNITED STATES OF AMERICA, *Respondent.*

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

PETITIONERS' REPLY MEMORANDUM

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IN THE

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OCTOBER TERM, 1977

No. 77-1016

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UNITED STATES OF AMERICA, *Respondent.*

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

PETITIONERS' REPLY MEMORANDUM

The petitioners herein feel compelled to submit this reply memorandum due to the fact that the Government's opposition to the Petition for Writ of Certiorari is premised upon a misstatement of fact. At page 4 of its Memorandum For The United States In Opposition, the Government states:

> "Despite the acknowledged conflict of decisions, we do not believe that the question presented warrants review by this Court at this time. *The Internal Revenue Service advises that there are no cases presently pending administratively or in the courts that involve the question.* In the last 12 years, *Statler Trust* and this case have been the only decided cases addressing the question." [Emphasis added.]

The Internal Revenue Service is in error. The petitioners are themselves aware of another case presenting the same question as that which is presented herein. The taxpayer in said other case is Security Pacific National Bank, as Executor of the Will of Hazel E. Wilson (Taxpayer I.D. No. 95-6218928). That taxpayer, for fiscal year ending September 30, 1969, paid or set aside to charity approximately $1,000,000 of net long-term capital gains. In the administrative proceedings concerning that taxpayer's fiduciary income tax return for said fiscal year, the Internal Revenue Service did not allow that taxpayer to compute the alternative tax in accordance with the method urged by the petitioners herein. Although said administrative proceedings have been completed, said other taxpayer still has time in which to bring suit for refund of income taxes, and if said taxpayer does so and is successful on the issue presented by the within Petition for Writ of Certiorari, said taxpayer stands to recover approximately $103,000 in income taxes.

Given the fact that the petitioners are personally aware of another case which, as set forth above, involves the same issue as that presented herein, it can be assumed that the Internal Revenue Service has overlooked other cases involving the same issue. Accordingly, no credence should be given to the Government's attempt, through its Memorandum in Opposition, to supplement the record herein.

Respectfully submitted,

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Supreme Court, U. S.
FILED
MAY 18 1978
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

October Term, 1977
No. 77-1016

UNITED CALIFORNIA BANK and LILLIAN DISNEY TRUYENS, Co-Executors of the Estate of WALTER E. DISNEY,

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UNITED STATES OF AMERICA,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

PETITIONERS' OPENING BRIEF.

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IN THE

Supreme Court of the United States

October Term, 1977
No. 77-1016

UNITED CALIFORNIA BANK and LILLIAN DISNEY TRUYENS, Co-Executors of the Estate of WALTER E. DISNEY,

Petitioners,

vs.

UNITED STATES OF AMERICA,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

PETITIONERS' OPENING BRIEF.

Opinions Below.

United California Bank v. United States (9th Cir. 1977), 563 F.2d 400, reversing *United California Bank v. U.S.* (C.D. Calif. 1974) 75-1 CCH U.S. Tax Cases ¶9164.

Jurisdiction.

The judgment of the United States Court of Appeals for the Ninth Circuit was entered on October 19, 1977, reversing the District Court's judgment dated December 9, 1974, in favor of the petitioners. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

Question Presented.

Whether the Court of Appeals erred in requiring the petitioners to include, in the amount of long-term capital gains subject to the alternative tax under § 1201(b) of the Internal Revenue Code of 1954, the portion of such gains which was owned by a tax-exempt charitable organization and held by the petitioners in their capacity as co-executors of a decedent's estate.

Statutes Involved.

The following statutes are printed in an appendix at the end of this brief. (All appear in the versions which were in effect during the taxable years in question.)

Internal Revenue Code (26 U.S.C.) § 501(a) and (c)(3)
Internal Revenue Code (26 U.S.C.) § 642(c)
Internal Revenue Code (26 U.S.C.) § 643(a)
Internal Revenue Code (26 U.S.C.) § 661(a)
Internal Revenue Code (26 U.S.C.) § 662(a)
Internal Revenue Code (26 U.S.C.) § 691(c)
Internal Revenue Code (26 U.S.C.) § 1201(b)
Internal Revenue Code (26 U.S.C.) § 1202
California Probate Code, § 300
California Probate Code, § 1000

Statement of the Case.

Petitioners are the co-executors of the estate of Walter E. Disney, who died on December 16, 1966, a resident of the County of Los Angeles, California. By the terms of his will, Mr. Disney left 45% of the residue

of his estate to the Disney Foundation, as trustee for both the Disney Foundation and the California Institute of the Arts, both of which entities are charitable organizations, exempt from tax under Internal Revenue Code § 501(c)(3) [26 U.S.C. § 501(c)(3)].[1]

During each of the years 1967 and 1968, the petitioners, as co-executors of Mr. Disney's estate, sold certain securities which were included in the residue of Mr. Disney's estate and realized long-term capital gains on said sale. Pursuant to the terms of Mr. Disney's will, 45% of said long-term capital gains was permanently set aside for the Disney Foundation, as charitable trustee.

In their Fiduciary Income Tax Returns for the years 1967 and 1968, the petitioners computed the estate's income tax by applying the alternative tax on capital gains provided by Internal Revenue Code § 1201(b).[2] At all times relevant to this case, § 1201(b) prescribed, in effect, a maximum tax of 25% on long-term capital gains, this tax being characterized as an "alternative tax" in the sense that it is utilized as an alternative to the "normal" tax provided by § 1202.[3] Since

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[1]See Appendix of Statutes Involved. All statutory provisions set forth therein appear in the versions which were in effect during the taxable years in question.

[2]See Appendix of Statutes Involved.

[3]See Appendix of Statutes Involved. Under the statutory language, neither the "normal" tax resulting from § 1202 nor the "alternative tax" resulting from the utilization of § 1201(b) is, in fact, imposed on long-term capital gains as such. Rather, such taxes are imposed on the "excess" of "net long-term capital gain" over "net short-term capital loss". However, in a situation which involves neither short-term nor long-term capital losses, it is simpler and no less accurate, in lieu of referring to such "excess", to refer simply to "net long-term capital gain" or, even more simply, to "long-term capital gains."

§ 1202 permits the taxpayer to deduct from gross income an amount equal to 50% of long-term capital gains, application of § 1202 results in an effective tax on long-term capital gains at a rate equal to one-half of the marginal rate at which the taxpayer's income is taxed. Thus when the taxpayer's marginal rate exceeds 50%, the effective rate on long-term capital gains resulting under § 1202 will exceed 25% and the taxpayer will, as an alternative, utilize the 25% rate provided by § 1201(b).[4]

At all times relevant to this case, § 501(c)(3) of the Internal Revenue Code exempted from income tax charitable organizations such as the Disney Foundation, and § 642(c)[5] allowed to estates and trusts an unlimited deduction for amounts paid to, or set aside for, such charitable organizations. Under the relevant local law, Calif. Probate Code § 300,[6] the Disney Foundation, as designated beneficiary under Mr. Disney's will, held title to 45% of the residue of Mr. Disney's estate from the time of his death, subject

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[4]In a technical sense, § 1202 is utilized even when one applies § 1201(b), since the computation of the alternative tax begins with taxable income, and since the computation of taxable income includes the 50% long-term capital gains deduction which is provided by § 1202. However, the computation of the "partial tax" under § 1201(b)(1) modifies taxable income by subtracting therefrom the other 50% of the long-term capital gains, thereby resulting in an amount subject to the partial tax which is equal to the taxpayer's ordinary net income. Since the substance of this "partial tax" computation is thus the deduction, or exclusion, of all the taxpayer's long-term capital gains, in lieu of the deduction of 50% thereof under § 1202, and since the "partial tax" is then supplemented by the 25% tax on capital gains provided by § 1201(b)(2), the alternative tax is, in substance, an "alternative" to the 50% capital gains deduction provided by § 1202.

[5]See Appendix of Statutes Involved.

[6]See Appendix of Statutes Involved.

to the possession of the petitioners and the control of the probate court for purposes of estate administration.

Based upon the foregoing statutory provisions, and the policy underlying them, petitioners viewed themselves, with respect to 45% of the estate's residue, merely as conduits for the Disney Foundation, having possession of property of which a tax-exempt charitable organization was the owner and receiving as such conduits any capital gains which resulted from sales out of that charitable organization's 45% interest. Accordingly, in computing the alternative tax under § 1201(b) in this case, the petitioners did not include the Disney Foundation's 45% interest in the capital gains in the amount of capital gains subject to the alternative tax. Thus, no tax was paid on the said 45% and the remaining 55% of the capital gains received the benefit of the alternative tax. This is the same result which would have occurred had the petitioners distributed to the Disney Foundation 45% of the securities which were sold and had that charitable organization sold said 45% of the securities on its own behalf.

The respondent, however, disallowed the petitioners' exclusion of the said 45% from the amount to which the alternative tax was applicable, the respondent taking the position that, in the application of the alternative tax in the case of an estate or trust, said tax must be imposed not only on that portion of the gain passing to taxable beneficiaries but also on that portion of the gain which is owned by a tax-exempt charitable beneficiary. As a consequence of respondent's disallowance, the alternative tax was unavailable to the Disney estate, and the petitioners were required to

pay additional amounts of tax and interest.[7] The petitioners paid said additional amounts of tax and interest and filed timely refund claims therefor. Following the respondent's disallowance of said refund claims, the

[7]The additional tax resulting from the application of § 1202 in this case may be demonstrated by a simplified example, using hypothetical figures. Assuming ordinary taxable income of $20,000. capital gains of $500,000, and a governing instrument giving 50% of the estate to charity, the estate would compute the tax under § 1201(b) by computing the "partial tax", under § 1201(b)(1), on the ordinary income (computed as follows: partial tax, assuming 30% effective rate = $20,000 × 30% = $6,000) and then adding to the "partial tax" the 25% capital gains tax, under § 1201(b)(2), computed on that 50% portion of the capital gains which was not set aside to charity (capital gains tax = $500,000 × 50% × 25% = $62,500). Thus, the total tax as computed by the estate under § 1201(b) would be $68,500 ($6,000 + $62,500 = $68,500).

Assuming a 60% effective rate under § 1202, the tax under that section would be computed by subtracting from gross income both the 50% capital gains deduction under § 1202 and the charitable set aside deduction under § 642(c), and by then applying the 60% rate to the balance, as follows:

§ 1202 tax = 60% × ($20,000 + $500,000 — $250,000 — $125,000)

§ 1202 tax = 60% × $145,000

§ 1202 tax = $87,000

Since the tax computed under § 1202 would thus exceed the tax computed by the estate under § 1201(b), the estate would utilize § 1201(b) and pay the lower tax resulting under that section.

Under respondent's theory, however, the capital gains tax under § 1201(b)(2) would be computed on 100% of the capital gains, including that portion owned by and set aside to charity. Thus, respondent would compute the § 1201(b)(2) capital gains tax as follows: $500,000 × 100% × 25% = $125,000. Since this amount alone exceeds the tax computed under § 1202, the respondent's position would compel the estate to apply § 1202, even though the tax resulting under § 1202 exceeds the tax computed under the petitioners' application of § 1201(b).

Petitioners herein recognize that the application of § 1202 does, in effect, exempt from tax the amount set aside to charity, as the tax is computed under that section. However,

petitioners filed the complaint herein, and, after a trial upon stipulated facts, the District Court rendered judgment in favor of the petitioners. The respondent thereupon filed its appeal, and, following the hearing of said appeal, the Ninth Circuit Court of Appeals reversed the judgment of the District Court and entered judgment for the respondent.

Thereafter, the petitioners filed herein their Petition for Writ of Certiorari. Said Petition was granted by Order of this Court dated March 20, 1978.

Summary of Argument.

The question presented by this case arises from the conjunction, in a particular context, of two fundamental principles of the federal income tax law. These two principles are, first, that the income of charitable organizations is exempt from taxation, and, second, that the income received by estates and trusts is given "conduit" treatment, in the sense that such income is treated generally as the income of the beneficiary for whose benefit it is received.[8] Thus, under the normal operation of these two principles, when an estate or trust receives income which it holds for ultimate distribution to a charitable beneficiary, such income is exempt from tax, even if not currently distributed to such charitable beneficiary.

as set forth hereinafter, this fact merely highlights the anomalous result of respondent's position, which is to deny tax exemption to such amounts when the tax is computed under § 1201(b). Congress can hardly have intended that estates and trusts having charitable beneficiaries be penalized in their utilization of § 1201(b), by comparison to the tax treatment accorded them under § 1202.

[8]Subject to certain limitations, relating to the timing of distributions, in the case of non-charitable beneficiaries.

The controversy in this case results from the fact that the respondent refuses to permit the operation of the foregoing two principles in the application of the "alternative tax" which Internal Revenue Code § 1201(b) provides with respect to long-term capital gains. As set forth above in the Statement of the Case, such tax is utilized as an alternative to the "normal" tax resulting under § 1202, when such utilization results in a lower overall tax burden. In the case of an estate or trust receiving capital gains for the benefit of a charitable beneficiary, the "normal" tax resulting under § 1202 will reflect the operation of the two principles referred to above, in that the capital gains passing to charity, even though passing through the intermediary of an estate or trust, pass free of income tax, and the tax imposed upon the estate or trust will be the same as that which would have occurred had the estate or trust never received the amounts of capital gains passing to charity.[9]

[9]The statutory mechanism through which this result is achieved is contained in § 642(c). This section, which implements the conduit principle in the case of charitable beneficiaries, essentially provides (in the form in which it existed during the years relevant to this case) for an unlimited deduction to the estate or trust for all amounts of "gross income . . . paid or permanently set aside for" charitable purposes. (Since long-term capital gains so "paid or permanently set aside" also qualify for the 50% capital gains deduction provided by § 1202, § 642(c) contains a provision requiring that "proper adjustment of the deduction otherwise allowable under this subsection shall be made for any deduction allowable to the estate or trust under section 1202." This adjustment is necessary in order to achieve a deduction which precisely equals, but does not exceed, the amount of capital gains which the estate or trust receives for its charitable beneficiaries.) Although § 642(c) speaks in terms of a "deduction", the effect of the section is to exclude from the taxable income of an estate or trust, as though never received by that entity, all amounts of gross income, including long-term capital gains, which are ultimately payable to charitable beneficiaries.

In spite of the fact that the application of the "normal" tax, in the case of an estate or trust receiving capital gains destined for charities, thus reflects the perfect operation of the conduit principle,[10] the respondent nevertheless contends that the application of the "alternative tax" in such cases should disregard the conduit theory and, in a case such as this one, result in a tax burden greater than that which would occur had the capital gains been received directly by the charitable beneficiaries.

As support for its position, the respondent relies upon a mechanical interpretation of § 1201(b), specifically subparagraph (b)(2) thereof, which provides, in addition to a "partial tax" computed under subparagraph (b)(1),[11] a tax "equal to 25 percent of the excess of the net long-term capital gain over the net short-term capital loss." Since the statutory language of subparagraph (b)(2) does not expressly contain any further characterization of the "excess" to which the 25% tax is to be applied, the respondent contends that such "excess", even in the case of an estate or

[10]The Ninth Circuit apparently disputes this conclusion, contending that a conduit approach to the "normal" tax computation would require that the capital gains passing to charity be deducted exclusively under § 642(c), rather than one-half under § 642(c) and one-half under § 1202. 563 F.2d 400, 404. Yet the resulting taxable income, as the Ninth Circuit's opinion makes clear, is the same in either event. (Compare the hypothetical computation of taxable income set forth at 563 F.2d 400, 402, with that set forth in fn. 6, 563 F.2d 400, 404). To contend in such circumstance that the particular mechanisms which Congress has prescribed "do not countenance a 'conduit' approach in calculating the normal tax" (563 F.2d 400, 405) is an exaltation not merely of form, but rather of the petty refinements of form, over the substance which emerges clearly from the statutory provisions.

[11]The "partial tax" under § 1201(b)(1) is designed to equal that amount of tax which would be imposed in the absence of net long-term capital gain.

trust having charitable beneficiaries, must include all of the net long-term capital gain received by the estate or trust, even that portion thereof which is owned by, and which the estate or trust is required to pass on to, its charitable beneficiaries.

The respondent defends this mechanical interpretation of § 1201(b) by contending that the conduit principle applies only to the non-charitable beneficiaries of an estate or trust and that the principle has no application in the case of charitable beneficiaries.

The respondent's error lies both in its needlessly restrictive approach to the language of § 1201(b) and in its failure to recognize the conduit principle's applicability to charitable beneficiaries of estates and trusts. As set forth more fully below, the applicability of the conduit principle to charitable beneficiaries is apparent not only from the statutory provisions of the Internal Revenue Code itself, but also from the long-standing judicial recognition of that applicability. Furthermore, nothing in the language of § 1201(b) prevents the operation of the conduit principle in the application of the alternative tax. To the contrary, there exists ample authority, discussed below, for a construction of § 1201(b) which permits deductions or exclusions from the amount of net long-term capital gain to which the alternative tax is applied. Additionally, the respondent's error is further evidenced by the absurd tax consequences in which the respondent's position herein will sometimes result.

ARGUMENT.

I

The Conduit Principle Underlying the Taxation of Estates and Trusts Is Applicable With Respect to Charitable Beneficiaries of Estates and Trusts.

The respondent's position in this case, and the Ninth Circuit's acceptance of that position, stem from their failure to recognize that the conduit principle applies not only with respect to non-charitable beneficiaries but also with respect to charitable beneficiaries of estates and trusts. When Congress enacted the Internal Revenue Code of 1954, it specifically confirmed the conduit principle's applicability to estates and trusts, without indicating any legislative intent that said principle should be less applicable to charitable beneficiaries than to non-charitable beneficiaries thereof. As set forth in the House Committee Report on the Internal Revenue Code of 1954, in its discussion of the general rules for the taxation of estates, trusts and their beneficiaries (as contained in §§ 641-643, which sections include § 642(c)), the House Ways and Means Committee observed that:

> "The bill adheres to the conduit theory of the existing law. This means that an estate or trust is in general treated as a conduit through which income passes to the beneficiary."
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> H.R. Rep. No. 1337, 83d Cong., 2d Sess., p. 61 (3 U.S. Code Cong. & Adm. News (1954), 4017, 4087)

Based upon this legislative history, the Second Circuit Court of Appeals squarely held that the conduit principle entitles estates and trusts to treat long-term capital gains received on behalf of charitable beneficiaries as

non-taxable even when the alternative tax is employed. *Statler Trust v. C.I.R.* (2nd Cir. 1966), 361 F.2d 128, rev'g *Ellsworth M. Statler Trust* (1964), 43 Tax Ct. 208. In *Statler,* the Second Circuit determined that trustees, who were required by their governing trust instrument to distribute at least 15 percent of the trust's net income each year to various charities, were entitled to exclude the 15 percent of the trust's long-term capital gains so distributed from the amount of long-term capital gains subject to the alternative tax under Section 1201(b). In so holding, the Second Circuit emphasized the controlling nature of the conduit principle in the taxation of estates and trusts, and the legislative intent that said principle be given effect. Quoting that portion of the House Committee Report set forth above (361 F.2d 128, 131), and recognizing the applicability of the conduit principle to the amounts of capital gains at issue in the case before it, the Second Circuit in *Statler* rejected the position advocated by the respondent and sustained the position of the petitioners herein.

Subsequent to the Second Circuit's decision in *Statler,* Congress has twice amended both § 1201(b) and § 642(c), in each case without changing either section in any respect relevant to the question herein. (See, P.L. 94-455, § 1901(a) (135)(C) and § 1901(b) (33), and P.L. 91-172, § 511(b), amending § 1201 (b); P.L. 94-455, §§ 1402(b)(1)(J), 1402(b)(2) and 1906(b)(13)(A), and P.L. 91-172, § 201(b), amending § 642(c).) By thus in effect reenacting the statutory language construed and applied by the Second Circuit in *Statler,* Congress must be deemed to have approved and adopted the Second Circuit's decision in that case. *Shapiro v. United States* (1948),

335 U.S. 1, 16-20, 68 S.Ct. 1375, 92 L.Ed. 1787, 1798-1800; *Sherman v. Hamilton* (1st Cir. 1961), 295 F.2d 516, 520, cert. den. 369 U.S. 820, 82 S.Ct. 827, 7 L.Ed.2d 785; *Commissioner of Internal Rev. v. F. G. Bonfils Trust* (10th Cir. 1940), 115 F.2d 788, 792; *Van Vranken v. Helvering* (2nd Cir. 1940), 115 F.2d 709, 710, cert. den. 313 U.S. 585, 61 S.Ct. 1095, 85 L.Ed. 1541.

Congress' ratification of the *Statler* decision should dictate the result in this case. Indeed, to the extent that the circumstances of this case differ factually from those of *Statler,* this case presents an even stronger situation for applying the Second Circuit's reasoning. In *Statler,* the governing trust instrument gave the trustees discretion to distribute each year not less than 15 percent nor more than 30 percent of the trust's net income for the year among such charitable organizations, and in such amounts, as the trustees determined. Consequently, it could not be said in the *Statler* case that any of the charitable beneficiaries of the trust had a vested right to any amount or portion of the trust's income. In this case, however, the Disney Foundation, under the terms of Mr. Disney's will and the relevant California law, held *title* to 45 percent of the residue of Mr. Disney's estate from the time of Mr. Disney's death, and the petitioners, as co-executors of Mr. Disney's estate, merely had *possession* of the estate residue for purposes of administration. Accordingly, the petitioners in this case were, in a more literal sense than were the trustees in *Statler,* mere conduits for a charitable beneficiary.[12]

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[12]This circumstance further distinguishes the petitioners' situation from that in *Weil v. Commissioner of Internal Revenue*

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Notwithstanding the foregoing, the Ninth Circuit herein rejected the applicability of the conduit principle and sustained the respondent's position that in the application of the alternative tax such tax must be imposed even on that portion of capital gains which is owned by, and set aside for, a tax-exempt charitable beneficiary. This conclusion by the Ninth Circuit is based not only on a misconstruction of the relevant provisions of the Internal Revenue Code, but also on a disregard of the historical recognition of the conduit principle as it applies to charitable beneficiaries.

A. Applicability of the Conduit Principle to Charitable Beneficiaries of Estates and Trusts Is Apparent From the Provisions of the Internal Revenue Code.

There is no dispute in this case concerning the applicability of the conduit principle to taxable beneficiaries of estates and trusts. As the respondent recognizes,[13] the conduit principle "is the theory underlying the taxation of trusts, estates, and their beneficiaries," and is implemented, with respect to taxable beneficiaries, by §§ 661 and 662 of the Internal Revenue Code. Section 661(a) provides that the estate or trust is allowed a deduction, in computing its taxable income, equal to the sum of "any amount of income required to be distributed currently" (§ 661(a)(1)),

(6th Cir. 1956), 229 F.2d 593, in which an individual taxpayer was not permitted to deduct his charitable contributions (in excess of his ordinary income) from the amount of his capital gains in computing the alternative tax thereon. As the Second Circuit noted in *Statler*, the voluntary nature of the taxpayer's charitable contributions in *Weil* afforded the court in that case no occasion to consider the applicability and effect of the conduit principle. 361 F.2d 128, 131.

[13]Brief for the Appellant pp. 7-8, filed May 29, 1975, in the Ninth Circuit Court of Appeals.

and "any other amounts properly paid or credited or required to be distributed for such taxable year" (§ 661(a)(2)). Section 662(a) essentially requires that a beneficiary receiving an amount described in § 661(a) include such amount in his gross income. Section 663(a)(2) excludes from the operation of § 661(a) and § 662(a) such amounts as are paid to or permanently set aside for charitable beneficiaries under § 642(c).

Sections 661(a) and 662(a) thus operate as what might be termed the "taxable conduit" of the estate or trust, moving taxable income from that entity to its taxable beneficiaries, to the extent of the estate or trust's actual or required distributions to such beneficiaries. However, because amounts passing to charitable beneficiaries, deductible under § 642(c), are not included within § 661(a) and § 662(a), the respondent has contended that the provisions of the Internal Revenue Code do not reflect the operation of the conduit principle with respect to charitable beneficiaries. The decision of the Ninth Circuit herein was premised upon its acceptance of that contention, which acceptance was in turn based upon the purported ground that conduit treatment for charitable beneficiaries does not "emerge boldly from the Code's language". 563 F.2d 400, 404. In thus denying the applicability of the conduit principle to charitable beneficiaries, both the respondent and the Ninth Circuit have disregarded the fact that § 642(c) is a compelling manifestation of such applicability.

In seeking statutory support for its rejection of the conduit principle's applicability to this case, the Ninth Circuit has reasoned that if the conduit principle were applicable to charitable beneficiaries, Congress would

have provided that amounts distributed to or set aside for charities are to be "excluded" from the gross income of the estate or trust rather than simply "deducted" as § 642(c) provides. Such reasoning overlooks the fact that the income of an estate or trust which is distributed through the "taxable conduit," under § 661 and § 662, is also not excluded from the gross income of the estate or trust but is simply deducted, in that case under § 661(a). The Ninth Circuit in this case appears to have concluded that since amounts distributed to or set aside for charitable beneficiaries are not given conduit treatment identical to that given to taxable beneficiaries, such amounts are not given conduit treatment at all. Such analysis, apparently premised on the Ninth Circuit's assumption that the conduit principle can be expressed through only one statutory scheme, ignores the fact that the statutory provisions governing the taxation of estates and trusts provide very clearly, albeit separately, for the conduit treatment of amounts passing to charitable beneficiaries, creating, in effect, one system of conduit treatment for taxable beneficiaries and a separate system of conduit treatment for charitable beneficiaries.

The system of conduit treatment for charitable beneficiaries, far from being absent in the provisions of the Internal Revenue Code, is in fact a far stronger manifestation of the conduit principle than that system of conduit treatment which is provided for taxable beneficiaries. Sections 661 and 662 provide conduit treatment for taxable beneficiaries by allowing as a deduction to the estate or trust, and requiring to be taken into income by the recipient, only such amounts as are "properly paid or credited or required to be distributed" during the taxable year. Other amounts,

properly retained by the estate or trust during the taxable year, are not given conduit treatment but are instead generally taxed to the estate or trust as that entity's taxable income.[14] On the other hand, § 642(c),

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[14]The amount of taxable income which can be thus moved through the "taxable conduit" is also limited by the reference, in both §661(a) and §662(a), to "distributable net income" (or "DNI", as it is commonly abbreviated), which is defined in §643(a). The Ninth Circuit's failure to recognize the applicability of the conduit principle in this case may, in part, stem from that Court's apparent confusion concerning the operation of §643(a). The function of §643(a) is to define DNI, which, in turn, functions as the measuring device for the "taxable conduit", in that it becomes the maximum amount which may be deducted by the estate or trust under §661 and taxed to the estate or trust's taxable beneficiaries under §662. (In effect, DNI is intended to represent the amount of "taxable income" which the estate or trust has available for passage through the "taxable conduit".) The computation of DNI under §643(a) also reflects, however, a recognition of the "charitable conduit" manifested in §642(c). Since all amounts distributed to or set aside for charity pass, in effect, through the "charitable conduit" in the computation of taxable income (in that through the operation of §642(c) they are effectively excluded from taxable income), such amounts should not be included in that amount (*i.e.*, "DNI") which becomes the measuring instrument for the "taxable conduit" (under §661 and §662). Section 643(a) accomplishes this result by taking "taxable income" as the starting point for the DNI computation.

Among the several modifications of "taxable income" which §643(a) prescribes in computing DNI is the deduction, or "exclusion", from taxable income of certain capital gains, not including, however, those capital gains which have been distributed to or set aside for charity. IRC §643(a)(3). Since these capital gains have already been effectively excluded from taxable income under §642(c) (on their way through the "charitable conduit"), to exclude such amounts *again* in computing DNI would be arbitrarily to reduce the amount of "taxable income" which the estate or trust is deemed to have available for passage through the "taxable conduit." Section 643(a)(3), by denying such second exclusion, neatly accomplishes the desired result.

The Ninth Circuit, however, misconstrues the operation of §643(a)(3), and reads the denial of a second exclusion of amounts of capital gains passing to charity as meaning that such amounts "remain in distributable net income" (563 F.2d

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which implements the conduit principle in the case of charitable beneficiaries, gives the estate or trust an unlimited deduction not only for amounts which are paid for charitable purposes during the taxable year, but also for amounts which during the taxable year are "permanently set aside" for such purposes. Thus, while the conduit principle as reflected in § 661 and § 662 operates only at the time of an actual or required distribution from an estate or trust, the conduit principle as manifested in § 642(c) operates from the moment of the estate or trust's receipt of the income item in question where, as in this case, such item is required to be set aside for charitable purposes.

400, 404), and that the "specific purpose [of §643(a)(3)] is to retain capital gains so paid or set aside in distributable net income . . ." (563 F.2d 400, 406). In reaching this conclusion the Ninth Circuit overlooks the fact that the computation of DNI begins with an amount (*i.e.*, "taxable income") from which capital gains passing to charity have already been excluded and that the denial of a second exclusion for such amounts in the computation of DNI does *not* mean that such amounts are *included* in DNI, as determined under §643(a). Notwithstanding the Ninth Circuit's misreading of §643(a), that section, operating together with §642(c), quite precisely accomplishes the desired result of not including in DNI those amounts of capital gain which pass through the "charitable conduit" under §642(c).

The error of treating capital gains passing to charity as includable in DNI is apparent not only from the language and function of §643(a), but also from the fact that the inclusion of such amounts in DNI would result in a double deduction to the estate or trust, permitting such amounts to be deducted not only under §642(c), as they should be, but also under §661 to the extent that distributions to taxable beneficiaries exceed other DNI. The corollary of this excess deduction to the estate or trust would be an excess amount of taxable income deemed received by the taxable beneficiaries under §662. Although the taxable beneficiaries might then claim, with some justification, that their conduit runneth over, this excessive shifting of taxable income would, presumably, be no more in furtherance of divine providence than of Congressional intent.

B. Applicability of the Conduit Principle to Charitable Beneficiaries of Estates and Trusts Has Been Judicially Recognized.

The applicability of the conduit principle in the context of charitable beneficiaries of estates and trusts has been judicially recognized since almost the earliest enactments of the modern federal income tax law. As early as the Revenue Acts of 1916 and 1918, it was recognized that "the purpose of the statute is to exempt from taxation all income essentially belonging to religious, charitable, scientific or educational corporations," *Slocum v. Bowers* (S.D.N.Y. 1926), 15 F.2d 400, 405, aff'd, *Bowers v. Slocum* (2nd Cir. 1927), 20 F.2d 350, and that "the expressed intent of the Congress . . . was to tax the income received by the estate which would pass to any person subject to taxation, but relieve from taxation the income set aside by the terms of the will for corporations of [charitable] character. . . ." *Bowers v. Slocum* (2nd Cir. 1927), 20 F.2d 350, 352.[15] As Judge Augustus

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[15]The first modern income tax statute, the Revenue Act of 1913, contained no provision for the taxation of estates or trusts as entities, and undistributed income of estates and trusts was thereby able to escape current taxation. In the Revenue Act of 1916, Congress moved to plug this gap, by inserting a provision which taxed an estate or trust on its undistributed income. While the Revenue Act of 1916 also contained a provision exempting charitable organizations from the income tax, it did not explicitly exempt from the income tax imposed on estates and trusts that portion of undistributed income which might be allocable to charitable beneficiaries. This omission Congress corrected in the Revenue Act of 1918, by inserting a provision which allowed an estate or trust an unlimited deduction for "any part of the gross income which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid to or permanently set aside for" charitable purposes. Revenue Act of 1918, Section 219(b), 40 Stats. 1057, 1071. In *Slocum v. Bowers* (S.D.N.Y. 1926), 15 F.2d 400, aff'd, *Bowers v. Slocum* (2nd Cir. 1927), 20 F.2d 350,

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Hand observed in the district court opinion in *Slocum v. Bowers, supra,*

> "It is quite clear that the primary purpose of the amendments [contained in the Revenue Acts of 1916 and 1918] taxing estates and trusts as entities was to reach income that had not theretofore been presently taxable at all. A design to tax income where the beneficial ownership is in corporations generally exempt under the law accordingly seems contrary to the history and spirit of the statute.
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> * * * *
>
> "I think it reasonable to suppose that the income on which income taxes must be paid by an executor while the estate is in process of administration

though the taxable year in question was covered by the Revenue Act of 1918, the government disputed the applicability of that Act's charitable deduction provision, apparently contending there that, since the decedent's will did not refer specifically to income, the income which the executors had permanently set aside for charitable purposes had not been set aside "pursuant to the terms of the will" within the language of Section 219(b) of the Revenue Act of 1918 and so did not qualify for the deduction provided by that section. Conceding the possible correctness of this interpretation of Section 219(b), District Judge Augustus Hand concluded that the income in question was exempt from tax regardless of the applicability or non-applicability of that particular section. As set forth in the text, *infra,* Judge Hand cited the limited purpose of the 1916 Act in first imposing the income tax on estates and trusts, the general exemption from income tax for charities contained both in the 1916 Act and in Section 231(6) of the 1918 Act, and the consequent inapplicability of the income tax to the income in question in the *Slocum* case, irrespective of whether such income was accorded an express statutory deduction. (While the Second Circuit in the *Slocum* case affirmed Judge Hand's decison on somewhat narrower grounds, that Court, as did Judge Hand, emphasized the Congressional intent to impose the tax only on such income in the possession of an estate or trust as would be subject to the tax but for the interposition of the estate or trust. See text, *supra,* immediately preceding this footnote.)

> or settlement is only such income as is ultimately taxable as such and that the liability of income to taxation does not depend on where the legal title is vested but upon who is ultimately entitled to the property constituting that income."
>
> *Slocum v. Bowers,* 15 F.2d 400, 403-404

The congressional intention to exempt from taxation "all income essentially belonging to" charitable organizations requires that such amounts not be subjected to tax simply because of an executor's failure to distribute such amounts to the charitable organization. This was expressly recognized by both the district and the circuit courts in the *Bowers v. Slocum* decisions. *Slocum v. Bowers, supra,* 15 F.2d 400, 405; *Bowers v. Slocum, supra,* 20 F.2d 350, 352. As the Circuit Court observed, in *Bowers v. Slocum,*

> "[To] make the imposition of the tax depend upon some act of the executors, which had no result in law upon the rights of the parties, . . . is not in accordance with what we have found to be the expressed intent of the Congress, which was to tax the income received by the estate which would pass to any person subject to taxation, but relieve from taxation the income set aside by the terms of the will for corporations of the character described."
>
> *Bowers v. Slocum,* 20 F.2d 350, 352

In spite of this clear judicial recognition of a Congressional intent, in providing for the taxation of estates with charitable beneficiaries, not to permit the imposition of the tax to turn upon a discretionary act or

omission of an estate's executors, such imposition of the tax is the inevitable consequence of the Ninth Circuit's decision in this case. If the petitioners, instead of selling the residuary securities allocable to the Disney Foundation, had, pursuant to California Probate Code, § 1000, made a partial distribution of those securities to the Foundation, there can be no question but that any gains realized by the Disney Foundation on its own subsequent sale of those securities would have been wholly exempt from tax, while at the same time the gains realized on the remaining 55 percent of the residuary securities would have been eligible for the alternative tax provided by Section 1201(b). The position of the respondent, and the Ninth Circuit's decision in this case, cause the amount of the tax to depend squarely upon whether the representative of the estate has exercised his discretion to seek a partial distribution of the estate, a result clearly at variance, not only with logic, but also with long recognized and clearly expressed Congressional intent.

II

Deductions From Long-Term Capital Gains Before Application of the Alternative Tax Are Permitted in Furtherance of Congressional Intent.

Compounding its rejection in this case of the conduit principle's applicability to charitable beneficiaries, the Ninth Circuit has purported instead to "interpret section 1201(b) . . . precisely as it is written," 563 F.2d 400, 405. Based upon its observation that the language of § 1201(b) does not expressly provide for any deductions from the amount of net long-term capital gain to which the alternative tax is applied, the Ninth Circuit has concluded that

> "[T]he excess of the net long-term capital gain over the net short-term capital loss for the purpose of this section is *required* to be computed without reduction for any amount distributed to or set aside for charity." [Emphasis added]
>
> 563 F.2d 400, 405

The Ninth Circuit's reading of § 1201(b), resulting in the supposed "requirement" set forth above, is not "precise" but merely procrustean. While the language of § 1201(b) does not expressly mandate a "reduction for . . . amount[s] distributed to or set aside for charity", the statute also does not, either expressly or by implication, prohibit such reduction; nor does the statute require that it be construed in derogation of other pertinent provisions of the Internal Revenue Code, such as § 642(c). The Ninth Circuit's total disregard of the significance of § 642(c), and of the conduit principle which (as discussed *supra*) is manifested therein, is an egregious violation of the pertinent rule of statutory construction recently reiterated by this Court in *Kokoszka v. Belford* (1974), 417 U.S. 642, 650, 94 S.Ct. 2431, 41 L.Ed.2d 374, 381:

> "When 'interpreting a statute, the court will not look merely to a particular clause in which general words may be used, but will take in connection with it the whole statute (or statutes on the same subject) and the objects and policy of the law, as indicated by its various provisions, and give to it such a construction as will carry into execution the will of the Legislature. . . .' Brown v Duchesne, 19 How 183, 194, 15 L Ed 595 (1857)."
>
> *Kokoszka v. Belford*, 417 U.S. 642, 650, 94 S.Ct. 2431, 41 L.Ed.2d 374, 381

Similarly, as this Court noted in *Philbrook v. Glodgett* (1975), 421 U.S. 707, 713-714, 95 S.Ct. 1893, 44 L.Ed.2d 525, 532-533:

> " 'In expounding a statute, we must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy.' United States v Heirs of Boisdoré, 8 How 113, 122, 12 L Ed 1009 (1849). Richards v United States, 369 US 1, 11, 7 L Ed 2d 492, 83 S Ct. 585 (1962); Chemehuevi Tribe of Indians v FPC, 420 US 395, 402-403, 43 L Ed 2d 279, 95 S Ct 1066 (1975). Our objective in a case such as this is to ascertain the congressional intent and give effect to the legislative will . . ."
>
> *Philbrook v. Glodgett*, 421 U.S. 707, 713, 95 S.Ct. 1893, 44 L.Ed.2d 525, 532-533

The Ninth Circuit's supposedly "precise" interpretation of § 1201(b), based upon its efforts to construe that section's language in a vacuum and in total disregard of the statutory context, plainly fails to give effect to the Congressional will which is manifested therein. Furthermore, such interpretation not only disregards the long established and clearly expressed Congressional policy that conduit treatment is to be accorded amounts passing to charitable beneficiaries of estates and trusts; it also ignores the fact that the supposedly "precise" language of § 1201(b) is "flexible" enough to permit, in appropriate situations, a deduction from the amount of capital gains to which the alternative tax is applied. The cases of *Meissner*

v. United States (Ct. Cl. 1966), 364 F.2d 409; *Read v. United States* (5th Cir. 1963), 320 F.2d 550; and *Estate of Harry B. Sidles* (1976), 65 Tax Ct. 873, demonstrate unequivocally that § 1201(b) permits a deduction from the amount of capital gains to which the alternative tax is applied, despite the absence of an express provision therefor, when the effect of permitting such deduction is in furtherance of Congressional intent.

In *Read v. United States* (5th Cir. 1963), 320 F.2d 550 and in *Meissner v. United States* (Ct. Cl. 1966), 364 F.2d 409, the Fifth Circuit Court of Appeals and the Court of Claims, respectively, held that the income tax deduction permitted by Internal Revenue Code Section 691(c), for the amount of estate tax allocable to income in respect of a decedent, could be used as a deduction from the estate's capital gains before application of the alternative tax. While acknowledging the absence of any express provision for such deduction in Section 1201(b), both Courts found the allowance of the deduction necessary in order to fulfill the Congressional purpose behind the Section 691(c) deduction, *i.e.*, the avoidance of imposition of both estate and income taxes on the amount included in an estate as income in respect of a decedent.[16]

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[16]Congress' reenactment of §1201(b), as set forth above (p. 12), and of §691(c) (See, P.L. 94-455, §§1901(a)(91), 2005(a)(4), and 2006(b)(3)), without amending either section in any respect relevant to the issue herein (or to the issue in the above cases) is further indicative of Congress' adoption of the petitioners' construction of §1201(b).

In the more recent case of *Estate of Harry B. Sidles* (1976), 65 Tax Ct. 873, the respondent effectively acquiesced in this "flexible" interpretation of § 1201(b), contending in *Sidles* that, where the income in respect of a decedent consists solely of long-term capital gains and the estate utilizes the alternative tax, the deduction provided by § 691(c) should be available *only* as a deduction from the capital gains to which the alternative tax is applied rather than being available also as a deduction from ordinary income.[17]

Although the *Read, Meissner* and *Sidles* cases were concerned primarily with a provision of the Internal Revenue Code not directly related to the conduit treatment of estates and trusts having charitable beneficiaries, that circumstance does not, contrary to the Ninth Circuit's conclusion herein, make those cases "inapposite to the issue before us". 563 F.2d 400, 405. The significance of those cases is that, notwithstanding the supposedly "precise" language of § 1201(b), deductions will be permitted thereunder where such deductions have the effect of implementing a Congressional policy reflected in other provisions of the Internal Revenue Code. The policy underlying § 691(c), which the courts in *Read* and *Meissner* (and the respondent in *Sidles*) recognized as sufficient to permit a deduction from capital gains under § 1201(b)(2), was:

> "[T]o provide approximately the same tax consequences in the case of a decedent whose gross

[17]The Tax Court rejected the respondent's argument in *Sidles*, holding instead that the estate could apply the § 691(c) deduction in whatever manner was most advantageous to it, which in that case meant using the deduction first against ordinary income, and then applying the excess against long-term capital gains before application of the alternative tax.

> estate includes claims to income as in the case of a decedent all of whose income receivables had been collected (and income tax paid thereon) prior to his death. * * * [2 Mertens, Law of Federal Income Taxation, sec. 12.102(b), ch. 12, p. 404.]"
>
> Quoted in *Estate of Harry B. Sidles*, 65 Tax Ct. 873, 886

At issue in the instant case is the Congressional policy to provide the same tax consequences in the case of an estate or trust receiving amounts of income for a charitable beneficiary as in the case of a charitable beneficiary receiving such amounts directly, without the interposition of the fiduciary entity (such tax consequences being, of course, the complete exemption of such amounts from tax). This policy, so long recognized as a fundamental purpose of the federal income taxation of estates and trusts having charitable beneficiaries,[18] should be at least as compelling in the instant case with respect to the interpretation of § 1201(b), as was the policy behind § 691(c) in the cases of *Read, Meissner* and *Sidles*.

Also illustrative of the philosophy of statutory construction appropriate to this case is *United States v. Pleasants* (1939), 305 U.S. 357, 59 S.Ct. 281, 83 L.Ed. 217. That case, while involving neither the conduit principle nor the construction of the alternative tax, did involve a conjunction of those special statutory tax provisions pertaining to charities with those pertaining to capital gains and losses. Under the revenue laws in effect at the time of the *Pleasants* case, an individual was permitted to deduct from his taxable

[18]See, *e.g., Slocum v. Bowers, supra,* 15 F.2d 400, 405.

income the amount of his charitable contributions, but only to the extent of "15 per centum of the taxpayer's net income . . .", and the issue in the *Pleasants* case was the proper measure of "net income", for purposes of that limitation, in a situation in which the taxpayer not only had made significant charitable contributions but also had incurred significant "capital net losses".[19] As against the government's argument that the statutory definition of "net income" on its face required capital losses to be deducted in computing "net income", the Supreme Court held that, based upon the special statutory provisions both for charities and for capital gains and losses, the term "net income", when used as the limiting measure of a taxpayer's deduction for charitable contributions, should be construed as "the taxpayer's net income which under the statutory scheme is actually subject to tax" (305 U.S. 357, 362, 83 L.Ed. 217, 220-221) prior to the "alternative" deduction for "capital net losses". Referring to its earlier opinion in *Helvering v. Bliss* (1934), 293 U.S. 144, 55 S.Ct. 17, 79 L.Ed. 246, the Supreme Court noted that:

> "We observed in the Bliss Case that the exemption of income devoted to charity and the reduction of the rate of tax on capital gains 'were liberalizations of the law in the taxpayer's favor, were begotten from motives of public policy, and are not to be narrowly construed.' That observation is equally pertinent here."
>
> *United States v. Pleasants,* 305 U.S. 357, 363, 59 S.Ct. 281, 83 L.Ed. 217, 221

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[19]Such losses were at that time subject to what amounted, in effect, to a mandatory "alternative" deduction, limiting the deductibility of "capital net losses" to a flat rate of 12½%.

The foregoing observation is equally pertinent to the instant case. Both "liberalizations of the law" referred to in the *Pleasants* case are at issue herein, and unless the Supreme Court is abruptly to reverse its prescription in that case that these liberalizations "are not to be narrowly construed", the position of the petitioners in this case must be sustained.

III

The Respondent's Interpretation of the Alternative Tax Will Have Absurd Tax Consequences.

The imposition of the higher income tax which results in this case from the respondent's mechanical interpretation of § 1201(b) operates as a penalty on the estate's possession of capital assets sold for the accounts of both charitable and non-charitable beneficiaries. This penalty, so clearly at variance with Congressional intent regarding the taxation of charities, serves to underscore the applicability of the conduit principle to the facts of this case. Equally indicative, however, of the conduit principle's general applicability to the taxation of capital gains received by an estate or trust for a charitable beneficiary, is the fact that in other situations, similar to the instant one but involving a slightly different combination of capital gains and ordinary income, the respondent's approach will result, not in an unintended penalty, as here, but rather in an equally unintended windfall for the taxpayer (coupled with an unintended, corresponding loss to the public revenues).

As discussed above, the respondent's position herein is premised on its reading of § 1201(b), specifically that portion of § 1201(b)(2) which refers to the "excess of the net long-term capital gain over the

net short-term capital loss."[20] Construing that "excess" (*i.e.*, the amount which is subject to the 25 percent tax under § 1201(b)(2)) as permitting no exclusion or deduction for amounts passing through an estate or trust to charity, the respondent, as consistency requires, construes the term "such excess" appearing in § 1201(b)(1) to mean the same thing.[21] Yet the "excess" referred to in subparagraph (b)(1), although the same "excess" as that referred to in subparagraph (b)(2), is the measure not of a tax but of a deduction, *i.e.*, that deduction, "equal to 50 percent of such excess", which is taken from taxable income in computing the "partial tax" under § 1201(b)(1). Since the computation of the "taxable income" from which this deduction is taken has already included a deduction equal to *100 percent* of the capital gains passing to charity

[20]As is described briefly above, the alternative tax under § 1201(b) is the sum of two distinct and separately computed taxes, one being the "partial tax" computed under § 1201(b)(1) and the other being the 25% capital gains tax computed under § 1201(b)(2). The object of the partial tax is to equal that amount of tax which would be imposed on the taxpayer's ordinary net income (*i.e.*, the amount of tax which would be imposed on the taxpayer's net income exclusive of net long-term capital gain), and the statute arrives at this result by computing the partial tax on an amount equal to "the taxable income reduced by an amount equal to 50 percent of [the] excess" of "the net long-term capital gain" over "the net short-term capital loss". Since the computation of the taxpayer's taxable income has already included a deduction, under § 1202, of 50% of the "excess" just referred to, the deduction of another 50% under § 1201(b)(1) results in an amount subject to the partial tax which should precisely equal the taxpayer's ordinary net income. Once the partial tax has been thus computed, the total alternative tax is then derived by adding to the "partial tax" the capital gains tax, computed under § 1202(b)(2), in "an amount equal to 25 percent of the excess of the net long-term capital gain over the net short-term capital loss."

[21]See, e.g., the hypothetical alternative tax computation under the respondent's approach, described in the Ninth Circuit's opinion herein, 563 F.2d 400, at 402-403.

(i.e., 50 percent under § 1202 and the remaining 50 percent under § 642(c)), the effect of the respondent's approach is to provide a cumulative deduction equal to 150 percent of such capital gains in computing the "partial tax" under § 1201(b)(1).[22]

This multiple deduction, while flowing inevitably from the respondent's mechanical approach to § 1201(b), can hardly have been countenanced by Congress as a part of its scheme for the taxation of charities and estates and trusts. The function of the "partial tax" computation under § 1201(b) is to determine the amount of tax which would be payable on ordinary net income alone, in the absence of net long-term capital gain.[23] Consequently, the allowance, in such computation, of a cumulative deduction *greater* than the amounts of such gain received by the estate or trust for its charitable beneficiaries is inconsistent with that purpose, resulting in a lower "partial tax" than was intended and creating a "partial" windfall to the estate or trust as a result of that entity's receiving amounts destined for charity.

Furthermore, the respondent's position herein is inconsistent not only on a conceptual level with the purpose of the alternative tax computations. In its practical effect, the multiple deduction which results, under § 1201(b)(1), from the respondent's position may in some cases more than offset the additional tax which results, under § 1201(b)(2), from the re-

[22]See the hypothetical computation referred to in footnote 21, *supra.*

[23]As described in footnote 20, *supra,* the total "alternative tax" is then determined by the addition to the partial tax of the flat 25% tax imposed with respect to net long-term capital gain under § 1201(b)(2).

spondent's interpretation of that subparagraph, thereby creating an overall windfall to the estate or trust in the form of a total alternative tax lower than that which would have resulted had the charitable and non-charitable interests been contained in separate taxable entities rather than combined in one.

Although the respondent's rejection of the conduit principle in its construction of § 1201(b) has resulted, in the instant case, in a higher alternative tax than did the petitioners' adherence to the conduit principle, the potential for the opposite result can be easily demonstrated by a simple hypothetical.[24] If, for example, one were to assume that the effective tax rate on ordinary net income was 60% and that the estate's receipts consisted of $125,000 in ordinary income and $500,000 in long-term capital gains, with one-half

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[24]In the instant case the respondent's approach resulted in a higher alternative tax than did the petitioners' due to the fact that the ordinary income received by the estate was inadequate to absorb fully the respondent's multiple deduction under § 1201(b)(1), thereby resulting in a partial "wastage" of that multiple deduction. This can be seen from the hypothetical which was used by the Ninth Circuit in its opinion below. 563 F.2d 400, 402. (Said hypothetical is based on rounded figures roughly approximating the estate's receipts during 1967 and is a slight variation of the hypothetical set forth, herein, in the text.)

In its opinion, the Ninth Circuit characterizes the petitioners as being "troubled" by this "wastage" and as utilizing the conduit approach to §1201(b) for the purpose of "eliminating the 'wastage'". 563 F.2d 400, 403. This characterization is incorrect. The real "wastage" which the conduit approach is intended to avoid is not the loss of an excessive and unintended multiple deduction resulting from the respondent's mechanical construction of the "partial tax" under §1201(b)(1), but rather the loss of the charitable exemption which results from the respondent's mechanical construction of the capital gains tax under §1201(b)(2).

of the capital gains being allocable to a charitable beneficiary, then the petitioners' and the respondent's respective determinations of the normal tax and the alternative tax would be the following:

With respect to the normal tax, both the petitioners and the respondent would compute the estate's taxable income as being $250,000, resulting in a normal tax of $150,000, as follows:

Gross Income		$625,000
Less: Sec. 1202 deduction	$250,000	
Sec. 642(c) deduction	125,000	
Total Deductions	$375,000	
Estate Taxable Income		$250,000
		x 60%
Normal Tax		$150,000

The petitioners, following the conduit approach, would determine the alternative tax to be $137,500, as follows:

Estate taxable income	$250,000
Less: 50% of that portion of the excess of net long-term capital gain over net short-term capital loss not permanently set aside for charity. (50% of $250,000)	$125,000
Partial Taxable Income	$125,000
Partial Tax (assuming 60% effective rate)	$ 75,000
Tax on Excess of Net Long-Term Capital Gain Over Net Short-Term Capital Loss Not Permanently Set Aside for Charity (25% of $250,000)	$ 62,500
Total Alternative Tax	$137,500

The respondent, following the mechanical approach for which it contends herein, would determine the alternative tax to be $125,000, as follows:

Estate Taxable Income	$250,000
Less: 50% of all the excess of net long-term capital gain over net short-term capital loss (50% of $500,000)	$250,000
Partial Taxable Income	0
Partial Tax (assuming 60% effective rate)	0
Tax on Excess of All Net Long-Term Capital Gain Over Net Short-Term Capital Loss (25% of $500,000)	$125,000
Total Alternative Tax	$125,000

Thus, in the foregoing hypothetical, both the petitioners' approach and the respondent's approach result in an alternative tax which is less than the normal tax, and, hence, each approach will result in the use of the alternative tax. However, the respondent's approach results in a lower alternative tax, due to the fact that the ordinary income is sufficient in the hypothetical to take full advantage of the multiple deduction which the respondent's approach creates for capital gains passing to charity. The petitioners' computation of the alternative tax, as does the agreed upon computation of the normal tax, results in a total tax equal in amount to that which would result had the amounts passing to charity never been held by the estate or trust and had the estate or trust instead been limited to interests of a non-charitable, taxable nature.[25] The

[25]Thus, in the absence of the capital gains passing to charity, the estate's receipts would consist of $250,000 in capital gains and $125,000 in ordinary income, and the normal tax and alternative tax would be computed as follows:

respondent's approach, on the other hand, through the multiple deduction which is the inevitable corollary of its mechanical interpretation of § 1201(b), results in a tax lower than that which would result in such case, creating a windfall for the taxpayer by virtue of the combination of both charitable and non-charitable interests in one estate or trust. It is inconceivable that Congress could have intended either this windfall, which results from such combination in the hypothetical, or the penalty which results from such combination (under the respondent's approach) in the instant case. Regardless of which side it may happen to favor in a particular case, the respondent's interpretation of § 1201(b) does clear violence to the Congressional intent "that an estate or trust [be] treated as a conduit through which income passes to the beneficiary." H.R. Rep. No. 1337, 83rd Cong., 2d Sess., p. 61 (3 U.S.

Normal Tax	
Gross Income	$375,000
Less: Sec. 1202 deduction	125,000
Estate Taxable Income	$250,000
	x 60%
Normal Tax	$150,000
Alternative Tax	
Estate taxable Income	$250,000
Less: 50% of the excess of net long-term capital gain over net short-term capital loss (50% of $250,000)	$125,000
Partial taxable income	$125,000
Partial tax (assuming 60% effective rate)	$ 75,000
Tax on Excess of Net Long-Term Capital Gain Over Net Short-Term Capital Loss (25% of $250,000)	$ 62,500
Total Alternative Tax	$137,500

As can be seen by comparison to the hypothetical example in the text, the foregoing amounts of normal tax and alternative tax are precisely the same as those which would result from the petitioners' application of the conduit principle.

Code Cong. & Adm. News (1954) 4017, 4087). The capricious nature of the divergencies from the Congressionally intended result which occur under the respondent's approach serves only further to heighten the incongruous and unreasonable nature of the respondent's construction of § 1201(b).[26]

Conclusion.

Few Congressional policies are more clearly evidenced in the Internal Revenue Code than the policy to exempt from taxation amounts passing to charitable organizations. As Judge Augustus Hand observed, in his district court opinion in *Slocum v. Bowers, supra,*

> "[I] believe that broadly speaking the purpose of the statute is to exempt from taxation all income essentially belonging to religious, charitable, scientific or educational corporations."
>
> *Slocum v. Bowers,* 15 F.2d 400, 405

[26]The Respondent will no doubt contend herein, as it did below, that its construction of § 1201(b) adheres more than does the petitioners' construction to the literal meaning of the statutory language. Even if one were to accept that contention, which the petitioners do not (since, as set forth above, the language of § 1201 (b) is equally consistent with the petitioners' construction thereof), the absurd consequences of the respondent's "literal" construction would, alone, require its rejection. "A literal application of a statute which would lead to absurd consequences is to be avoided whenever a reasonable application can be given which is consistent with the legislative purpose. [Citations omitted]" *United States v. Ryan* (1931), 284 U.S. 167, 175, 52 S.Ct. 65, 76 L.Ed. 224, 229.

In a similar vein, this Court has more recently renewed its observation that " '[i]t is a familiar rule, that a thing may be within the letter of the statute and yet not within the statute, because not within its spirit, nor within the intention of its makers.' Church of the Holy Trinity v United States, 143 US 457, 459, 36 LEd 226, 12 SCt 511 (1892)." *Philbrook v. Glodgett* (1975), 421 U.S. 707, 714, 95 S.Ct. 1893, 44 L.Ed.2d 525, 533.

It has long been recognized that both the statutory provisions granting favored tax treatment to charities, and those granting such treatment to long-term capital gains, "were begotten from motives of public policy, and are not to be narrowly construed." *United States v. Pleasants* (1939), 305 U.S. 357, 363, 59 S.Ct. 281, 83 L.Ed. 217, 221, *supra,* quoting from *Helvering v. Bliss* (1934), 293 U.S. 144, 151, 55 S.Ct. 17, 20, 79 L.Ed. 246, 251. The respondent's position in this case violates the foregoing precept in both respects. The interpretation of § 1201(b) for which the respondent herein contends is not only an unduly narrow construction of the statutory provisions favoring long-term capital gains. It is, perhaps more significantly, by its necessary effect, an unduly narrow construction of the policy of charitable exemption which underlies the Internal Revenue Code. Regardless of whether the taxable beneficiaries or the charitable beneficiaries of the estate in this case were to bear the additional tax which results from the respondent's position, the inevitable consequence of such tax would be to increase the cost of, and hence to discourage, individual contributions to charity. Such consequence, so manifestly inconsistent with the strong Congressional tax policy favoring charities, can be easily avoided by a reasonable construction of the statutory provisions pertinent to this case.

For all of the reasons stated herein, the petitioners respectfully request that the decision by the Ninth Circuit Court of Appeals herein be reversed.

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APPENDIX OF STATUTES INVOLVED.

26 U.S.C. § 501.

(a) EXEMPTION FROM TAXATION.—An organization described in subsection (c) or (d) or section 401(a) shall be exempt from taxation under this subtitle unless such exemption is denied under section 502, 503, or 504.

(c) LIST OF EXEMPT ORGANIZATIONS.—The following organizations are referred to in subsection (a):

* * *

(3) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office. (All statutory provisions set forth herein appear in the respective versions of such provisions which were in effect during the taxable years in question.)

26 U.S.C. § 642.

* * *

(c) DEDUCTION FOR AMOUNTS PAID OR PERMANENTLY SET ASIDE FOR A CHARITABLE PURPOSE.—In the case of an estate or trust (other than a trust meeting the specifications of subpart B) there shall be allowed as a

deduction in computing its taxable income (in lieu of the deductions allowed by section 170(a), relating to deduction for charitable, etc., contributions and gifts) any amount of the gross income, without limitation, which pursuant to the terms of the governing instrument is, during the taxable year, paid or permanently set aside for a purpose specified in section 170(c), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance or operation of a public cemetery not operated for profit. For this purpose, to the extent that such amount consists of gain from the sale or exchange of capital assets held for more than 6 months, proper adjustment of the deduction otherwise allowable under this subsection shall be made for any deduction allowable to the estate or trust under section 1202 (relating to deduction for excess of capital gains over capital losses). In the case of a trust, the deduction allowed by this subsection shall be subject to section 681 (relating to unrelated business income and prohibited transactions).

26 U.S.C. § 643.

(a) DISTRIBUTABLE NET INCOME.—For purposes of this part, the term "distributable net income" means, with respect to any taxable year, the taxable income of the estate or trust computed with the following modifications—

(1) DEDUCTION FOR DISTRIBUTIONS.—No deduction shall be taken under sections 651 and 661 (relating to additional deductions).

(2) DEDUCTION FOR PERSONAL EXEMPTION.—No deduction shall be taken under

section 642(b) (relating to deduction for personal exemptions).

(3) CAPITAL GAINS AND LOSSES.—Gains from the sale or exchange of capital assets shall be excluded to the extent that such gains are allocated to corpus and are not (A) paid, credited, or required to be distributed to any beneficiary during the taxable year, or (B) paid, permanently set aside, or to be used for the purposes specified in section 642(c). Losses from the sale or exchange of capital assets shall be excluded, except to the extent such losses are taken into account in determining the amount of gains from the sale or exchange of capital assets which are paid, credited, or required to be distributed to any beneficiary during the taxable year. The deduction under section 1202 (relating to deduction for excess of capital gains over capital losses) shall not be taken into account.

(4) EXTRAORDINARY DIVIDENDS AND TAXABLE STOCK DIVIDENDS.—For purposes only of subpart B (relating to trusts which distribute current income only), there shall be excluded those items of gross income constituting extraordinary dividends or taxable stock dividends which the fiduciary, acting in good faith, does not pay or credit to any beneficiary by reason of his determination that such dividends are allocable to corpus under the terms of the governing instrument and applicable local law.

(5) TAX-EXEMPT INTEREST.—There shall be included any tax-exempt interest to which section 103 applies, reduced by any amounts which would be deductible in respect of disbursements

allocable to such interest but for the provisions of section 265 (relating to disallowance of certain deductions).

(6) INCOME OF FOREIGN TRUST.—In the case of a foreign trust—

(A) There shall be included the amounts of gross income from sources without the United States, reduced by any amounts which would be deductible in respect of disbursements allocable to such income but for the provisions of section 265(1) (relating to disallowance of certain deductions).

(B) Gross income from sources within the United States shall be determined without regard to section 894 (relating to income exempt under treaty).

(C) Paragraph (3) shall not apply to a foreign trust created by a United States person. In the case of such a trust, (i) there shall be included gains from the sale or exchange of capital assets, reduced by losses from such sales or exchanges to the extent such losses do not exceed gains from such sales or exchanges, and (ii) the deduction under section 1202 (relating to deduction for excess of capital gains over capital losses) shall not be taken into account.

(7) DIVIDENDS.—There shall be included the amount of any dividends excluded from gross income pursuant to section 116 (relating to partial exclusion of dividends received).

If the estate or trust is allowed a deduction under section 642(c), the amount of the modifications specified in paragraphs (5) and (6) shall be reduced to the extent that the amount of income which is paid, permanently set aside, or to be used for the purposes specified in section 642(c) is deemed to consist of items specified in those paragraphs. For this purpose, such amount shall (in the absence of specific provisions in the governing instrument) be deemed to consist of the same proportion of each class of items of income of the estate or trust as the total of each class bears to the total of all classes.

26 U.S.C. § 661.

(a) DEDUCTION.—In any taxable year there shall be allowed as a deduction in computing the taxable income of an estate or trust (other than a trust to which subpart B applies), the sum of—

(1) any amount of income for such taxable year required to be distributed currently (including any amount required to be distributed which may be paid out of income or corpus to the extent such amount is paid out of income for such taxable year); and

(2) any other amounts properly paid or credited or required to be distributed for such taxable year;

but such deduction shall not exceed the distributable net income of the estate or trust.

26 U.S.C. § 662.

(a) INCLUSION—Subject to subsection (b), there shall be included in the gross income of a beneficiary to whom an amount specified in section 661 (a) is paid, credited, or required to be distributed (by an

estate or trust described in section 661), the sum of the following amounts:

(1) AMOUNTS REQUIRED TO BE DISTRIBUTED CURRENTLY.—The amount of income for the taxable year required to be distributed currently to such beneficiary, whether distributed or not. If the amount of income required to be distributed currently to all beneficiaries exceeds the distributable net income (computed without the deduction allowed by section 642 (c), relating to deduction for charitable, etc. purposes) of the estate or trust, then, in lieu of the amount provided in the preceding sentence, there shall be included in the gross income of the beneficiary an amount which bears the same ratio to distributable net income (as so computed) as the amount of income required to be distributed currently to such beneficiary bears to the amount required to be distributed currently to all beneficiaries. For purposes of this section, the phrase "the amount of income for the taxable year required to be distributed currently" includes any amount required to be paid out of income or corpus to the extent such amount is paid out of income for such taxable year.

(2) OTHER AMOUNTS DISTRIBUTED.—All other amounts properly paid, credited, or required to be distributed to such beneficiary for the taxable year. If the sum of—

(A) the amount of income for the taxable year required to be distributed currently to all beneficiaries, and

(B) all other amounts properly paid, credited, or required to be distributed to all beneficiaries

exceeds the distributable net income of the estate or trust, then, in lieu of the amount provided in the preceding sentence, there shall be included in the gross income of the beneficiary an amount which bears the same ratio to distributable net income (reduced by the amounts specified in (A)) as the other amounts properly paid, credited or required to be distributed to the beneficiary bear to the other amounts properly paid, credited, or required to be distributed to all beneficiaries.

26 U.S.C. § 691.

* * *

(c) DEDUCTION FOR ESTATE TAX.—

(1) ALLOWANCE OF DEDUCTION.—

(A) GENERAL RULE.—A person who includes an amount in gross income under subsection (a) shall be allowed, for the same taxable year, as a deduction an amount which bears the same ratio to the estate tax attributable to the net value for estate tax purposes of all the items described in subsection (a) (1) as the value for estate tax purposes of the items of gross income or portions thereof in respect of which such person included the amount in gross income (or the amount included in gross income, whichever is lower) bears to the value for estate tax purposes of all the items described in subsection (a)(1).

(B) ESTATES AND TRUSTS.—In the case of an estate or trust, the amount allowed as a deduction under subparagraph (A) shall be computed by excluding from the gross income of the estate or trust the portion (if any) of the items described in subsection (a)(1) which is properly paid, cred-

ited, or to be distributed to the beneficiaries during the taxable year. This subparagraph shall apply to the same taxable years, and to the same extent, as is provided in section 683.

(2) METHOD OF COMPUTING DEDUCTION.—For purposes of paragraph (1)—

(A) The term "estate tax" means the tax imposed on the estate of the decedent or any prior decedent under section 2001 or 2101, reduced by the credits against such tax.

(B) The net value for estate tax purposes of all the items described in subsection (a)(1) shall be the excess of the value for estate tax purposes of all the items described in subsection (a)(1) over the deductions from the gross estate in respect of claims which represent the deductions and credit described in subsection (b). Such net value shall be determined with respect to the provisions of section 421(c)(2), relating to the deduction for estate tax with respect to stock options to which part II subchapter D applies.

(C) The estate tax attributable to such net value shall be an amount equal to the excess of the estate tax over the estate tax computed without including in the gross estate such net value.

26 U.S.C. § 1201.

* * *

(b) OTHER TAXPAYERS.—If for any taxable year the net long-term capital gain of any taxpayer (other than a corporation) exceeds the net short-term capital loss, then, in lieu of the tax imposed by sections 1 and 511, there is hereby imposed a tax (if such tax is

less than the tax imposed by such sections) which shall consist of the sum of—

(1) a partial tax computed on the taxable income reduced by an amount equal to 50 percent of such excess, at the rate and in the manner as if this subsection had not been enacted, and

(2) an amount equal to 25 percent of the excess of the net long-term capital gain over the net short-term capital loss.

26 U.S.C. § 1202.

In the case of a taxpayer other than a corporation, if for any taxable year the net long-term capital gain exceeds the net short-term capital loss, 50 percent of the amount of such excess shall be a deduction from gross income. In the case of an estate or trust, the deduction shall be computed by excluding the portion (if any), of the gains for the taxable year from sales or exchanges of capital assets, which, under sections 652 and 662 (relating to inclusions of amounts in gross income of beneficiaries of trusts), is includible by the income beneficiaries as gain derived from the sale or exchange of capital assets.

California Probate Code, § 300.

Estates All Subject to Court Administration—Exceptions

When a person dies, the title to his property, real and personal, passes to the person to whom it is devised or bequeathed by his last will, or, in the absence of such disposition, to the persons who succeed to his estate as provided in Division II of this code; but all of his property shall be subject to the possession

of the executor or administrator and to the control of the superior court for the purposes of administration, sale or other disposition under the provisions of Division III of this code, and shall be chargeable with the expenses of administering his estate, and the payment of his debts and the allowance to the family, except as otherwise provided in this code.

California Probate Code, § 1000.

Petition for Distribution, Preliminary—2 Months After Notice

When two months have elapsed after the first publication of notice to creditors and upon bond—or with or without bond, as the court determines, when the time for filing or presenting claims has expired and all uncontested claims have been paid or are sufficiently secured by mortgage, or otherwise, but the estate is not in a condition to be finally closed and distributed—the executor or administrator, or any heir, devisee or legatee, or the assignee, grantee or successor in interest of any heir, devisee, or legatee, may petition the court for distribution of a legacy, devise or share of the estate or any portion or portions thereof to which he is entitled or a payment on account of the legacies to the heirs, devisees or legatees or any assignees, grantees, or successors in interest or where there are priorities, to those of the class or classes having priorities; or, if the decedent was a nonresident and left a will which has been duly proved or allowed in the state of his residence, and such will has been admitted to probate in this state pursuant to Article 4 (commencing with Section 360) of Chapter 1 of Division 3 of this code, or if he died intestate, and

an administrator has been duly appointed and qualified in the state of his residence, and it is necessary, in order that the estate or any part thereof may be distributed according to the will, or it is for the best interests of the estate, that any part of the estate in this state should be delivered to the executor or administrator in the state of the decedent's residence, the executor or administrator may petition the court for an order authorizing the delivery of such portion of the estate as the court shall deem safe and proper and for the best interests of the estate, to the executor or administrator in the state of decedent's residence.

The clerk shall set the petition for hearing by the court and give notice thereof for the period and in the manner required by Section 1200 of this code. Any person interested in the estate or any coexecutor or coadministrator may resist the application.

Service of the within and receipt of a copy thereof is hereby admitted this ..... day of May, A.D. 1978.

_____

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_____

Supreme Court, U. S.
FILED
JUL 11 1978
MICHAEL RODAK, JR., CLERK

No. 77-1016

In the Supreme Court of the United States

OCTOBER TERM, 1978

UNITED CALIFORNIA BANK and LILLIAN DISNEY TRUYENS, CO-EXECUTORS OF THE ESTATE OF WALTER E. DISNEY, PETITIONERS

v.

UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES

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In the Supreme Court of the United States

OCTOBER TERM, 1978

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UNITED CALIFORNIA BANK and LILLIAN DISNEY TRUYENS, CO-EXECUTORS OF THE ESTATE OF WALTER E. DISNEY, PETITIONERS

v.

UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The findings of fact and conclusions of law of the district court (A. 54-56) are not officially reported. The opinion of the court of appeals (Pet. App. 4-15)[1] is reported at 563 F.2d 400.

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[1] There is a typographical error in the reproduction of an example in the court of appeals' opinion in the third sentence at Pet. App. 7. That sentence should read: "Assume further that in 1967 the estate realized and recognized $50,000 in ordinary income and $500,000 consisting of long-term capital gains." See 563 F.2d at 402.

JURISDICTION

The judgment of the court of appeals was entered on October 21, 1977, as of October 19, 1977 (A. 4-5). The petition for a writ of certiorari was filed on January 17, 1978, and was granted on March 20, 1978. The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the alternative capital gains tax computation by an estate under Section 1201(b) of the Internal Revenue Code of 1954 precludes a deduction from long-term capital gains for the amount of such gains set aside by the estate for charity.

STATUTES INVOLVED

The pertinent provisions of Sections 642(c), 643(a), 661(a), 662, 663(a)(2), 1201(b), and 1202 of the Internal Revenue Code of 1954, as amended (26 U.S.C., 1964 ed.), are set forth in the Appendix, *infra*. pp. 1a-9a.

STATEMENT

1. Petitioners are the co-executors of Walter E. Disney, who died on December 16, 1966. By his will, Disney left 45 percent of the residue of his estate to the Disney Foundation, in trust for the Foundation, and for the California Institute of the Arts. During 1967 and 1968, the years in question, the Foundation, the Institute, and the trust created by the will under which the Foundation is trustee, were qualified charitable organizations within the meaning of Sections 170(c)(2) and 501(c)(3) of the Internal Revenue Code of 1954 (Stip. of Facts, ¶¶ 1, 2, A. 6).

In 1967 and 1968, petitioners sold certain securities included in the residue of the estate and realized net long-term capital gains of $500,622.38 and $1,058,018.43, respectively. The estate incurred no short-term capital losses during those years. In 1967, the estate realized a net short-term capital gain of $16,944.16. Pursuant to the terms of Disney's will, petitioners set aside 45 percent of the net long-term capital gains, as part of the residue of the estate, to the Foundation, as trustee for the Foundation and the Institute (Stip. of Facts, ¶¶ 4, 5, A. 7).

For the years in question, the Internal Revenue Code prescribed two methods for the computation of the tax on the capital gains of non-corporate taxpayers, *viz.*, the "normal" and "alternative" methods respectively imposed by Sections 1202 and 1201. Under the normal method, the taxpayer deducts from his gross income an amount equal to 50 percent of the excess of net long-term capital gains over net short-term capital losses. After subtraction of other deductible items, the resulting figure (taxable income) is taxed at the ordinary graduated rates.

The alternative method is applicable only if it produces a lower tax liability than the normal method. For non-corporate taxpayers such as the Disney Estate, the alternative method of Section 1201(b) involves a two-step process. First, a partial tax is com-

puted at the ordinary rates on the taxable income (as computed above), reduced by the remaining 50 percent of the excess of the net long-term capital gains over the net short-term capital losses (step 1). Second, a 25 percent tax is imposed on the excess of the net long-term capital gains over the net short-term capital losses (step 2). The alternative tax is the sum of these two computations.

In the fiduciary income tax returns filed by petitioners on behalf of the estate for 1967 and 1968, petitioners claimed the benefit of the alternative method of computing the capital gains tax (Stip. of Facts, ¶ 6, A. 7; Exs. B, D, A. 35, 48). In computing the tax under the alternative method, petitioners first deducted from taxable income an amount equal to 50 percent of the remaining long-term capital gains from which the amount of such gains set aside for charity had been excluded (step 1); they also deducted the amount set aside for charity from the net long-term capital gains subject to the flat 25 percent tax (step 2). Petitioners' alternative tax computation resulted in a lower tax under the alternative method than under the normal method (Ex. B, pp. 1, 4, A. 35).

On audit, the Commissioner of Internal Revenue determined that petitioners' alternative tax computation was erroneous insofar as it deducted the amount set aside for charity from the net long-term capital gains base subject to the flat 25 percent tax. The Commissioner based his determination on the fact that

Section 1201(b)(2) does not permit any deduction from the capital gains tax base because it defines that base as "an amount equal to 25 percent of the excess of the net long-term capital gain over the net short-term capital loss." He therefore disallowed petitioners' claimed charitable deductions from the capital gains base. These adjustments resulted in an alternative tax liability greater than that produced under the normal method for each of the years in question. The Commissioner therefore concluded that petitioners should have employed the normal method of computing the estate's capital gains tax and accordingly issued assessments against the estate (Stip. of Facts, ¶ 8, A. 8).

2. The controversy between the parties concerning the correct interpretation of the statute may be illustrated by setting forth the figures for one of the two years at issue. There is no dispute with respect to the computation of the estate's Section 1202 normal tax. Using the figures for 1967, rounded off for purposes of illustration, the normal tax would be computed as follows:

Normal Tax

Estate gross income, including long-term capital gain of $500,000		$595,000
Less:	Charitable deduction	($145,000) [2]
	Section 1202 deduction (50 percent of $500,000 excess of long-term capital gains over short-term capital losses)	($250,000)
	Miscellaneous deductions	($95,000) 54,000
Estate Taxable Income		$146,000
Tax (regular rates)		$88,000

The dispute between the parties involves the computation of the Section 1201(b) alternative tax. Petioners' and the Commissioner's methods of computation for 1967 are respectively as follows:

Alternative Tax Computations

A. *Petitioners' Method*

1. Estate taxable income		$146,000
Less:	50 percent reduction of "excess" of net long-term capital gain over net short-term capital loss under Section 1201(b)(1)	($137,500)

[2] Although the estate set aside $225,000 (45 percent of $500,000 long-term capital gain), Section 642(c)(4) requires that this amount be adjusted to take into account the Section 1202 deduction and thereby prevent a double deduction. Section 642(c)(4) codified this Court's decision in *United States* v. *Benedict*, 338 U.S. 692. Thus, the estate was permitted a charitable deduction of only one-half of the $225,000 or $112,500, since the other half is included in the Section 1202 deduction. The remaining amount ($32,500) of the $145,000 charitable deduction was attributable to short-term capital gain and ordinary income set aside for charitable legatees.

	Petitioners computed this "excess" by reducing the long-term capital gain of $500,000 by the 45 percent paid to charity (or $225,000), leaving a balance of $275,000 (50 percent of $275,000=$137,500)	
	Partial taxable income	$8,500
	Tax (at normal rates) on partial taxable income	$1,800
	plus	
2.	Tax on long-term capital gain (25 percent x $275,000) under Section 1201(b)(2))	$69,000
	Total tax	$70,800

B. *The Commissioner's Method*

1. Estate taxable income		$146,000
Less:	50 percent reduction of "excess" of net long-term capital gain over net short-term capital loss under Section 1201(b)(1)	($250,000)
	This "excess" represents the entire $500,000 of long-term capital gain unreduced by the amounts set aside for charity	
	Partial taxable income	-0-
	Tax (at normal rates) on partial taxable income	-0-
	plus	
2.	Tax on long-term capital gain (25 percent of $500,000) under Section 1201(b)(2)	$125,000
	Total tax	$125,000

The foregoing computations illustrate the critical point of difference between the parties. Under petitioners' method of computing the alternative tax, the $500,000 long-term capital gain is reduced by the estate's set-aside to charity in the second step of the computation so as to decrease the capital gains subject to the flat 25 percent rate. That approach resulted in an alternative tax ($70,800) that was less than the normal tax ($88,000). However, under the Commissioner's method, the amount set aside for charity does not reduce the net long-term capital gains subject to the 25 percent rate. The Commissioner's method resulted in a normal tax ($88,000) that was less than the alternative tax ($125,000).[3]

The Commissioner's disallowances resulted in assessments for additional taxes against the estate for 1967 and 1968.[4] After paying the additional assessments, petitioners brought this refund suit in the United States District Court for the Central District of California.

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[3] Petitioners excluded from the alternative tax computation $225,280.07 and $476,108.30 from net long-term capital gains for 1967 and 1968, respectively (Ex. p. 4, A. 34; Ex. D, p. 1 Schedule D, p. 2, A. 48). However, the Commissioner allowed charitable deductions for those years of $144,738.96 and $352,335.01 under Section 642(c)(4) only under the normal tax computation. See also p. 6, n. 2, *supra*.

[4] The situation is the same for 1968, except that the dollar difference between the parties is larger. For that year, the normal tax was $189,000. The alternative tax was $146,000 under petitioners' method and $265,000 under the Commissioner's method.

The district court upheld petitioners' claim on the authority of the majority opinion in *Statler Trust* v. *Commissioner*, 361 F.2d 128 (C.A. 2) (A. 54-56). It ruled that amounts of long-term capital gain set aside by the estate for charity may be deducted in computing " 'the excess of the net long-term capital gain over the net short-term capital loss' " under the Section 1201(b) alternative tax (A. 55).

The court of appeals unanimously reversed (Pet. App. 4-15). As it viewed the matter, "[t]he Code could be drafted in a manner that would conform to the taxpayer's wishes. Unfortunately, it is not so written" (Pet. App. 9). It concluded that "the proper course is to follow closely the Code's precise language" and therefore "interpret[ed] section 1201(b), which describes the method by which the alternative tax is to be computed, precisely as it is written" (Pet. App. 12). Since the statutory term—"the excess of the net long-term capital gain over the net short-term capital loss"—does not authorize any deduction for amounts distributed to or set aside for charity, the court of appeals rejected petitioners' claimed charitable deduction in the context of the alternative tax computation (*ibid.*). In so holding, the court was persuaded by the analysis of the dissenting judge in *Statler Trust* v. *Commissioner*, *supra*, 361 F.2d at 133, who stated: "The statute's effect is too plain to be supposed an inadvertent one, and it is far from being ungenerous. The alternatives are payment of tax at ordinary rates on half the capital gain less the adjusted deduction for the part of it paid to charity or paying a tax on

that same income amount equal to a quarter of the total capital gain" (Pet. App. 14).

SUMMARY OF ARGUMENT

A.

There are two methods of computing the tax on long-term capital gains for a non-corporate taxpayer. Under the so-called "normal" method of Section 1202 of the Internal Revenue Code of 1954, the taxpayer includes the net long-term capital gain in gross income and then deducts 50 percent of the net long-term capital gains.[8] The resulting figure (taxable income) is taxed at the ordinary graduated rates. Section 1201 (b) prescribes an "alternative" tax, calculated in two steps and applied when resulting in a lower tax liability than the normal method. The first step computes a partial tax at the ordinary rates on the taxable income reduced by the remaining 50 percent of the net long-term capital gain. This step effectively removes the net long-term capital gain from the computation, and subjects the remaining income to the partial tax at progressive rates. The second step imposes a 25 percent tax on the net long-term capital gain. The alternative tax is the sum of the partial tax and the 25 percent tax.

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[8] Petitioners incurred no net short-term capital losses during the years in question. Hence, for purposes of simplicity, we use the term "net long-term capital gain" rather than the statutory equation "excess" of "net long-term capital gain" over "net short-term capital loss."

1. The court of appeals correctly held that petitioners, who are executors of an estate which earned long-term capital gains, could not offset the alternative capital gains tax base by the amount of such gains set aside for charity. The plain language of Section 1201(b)(2), which imposes a 25 percent tax on "the excess of the net long-term capital gain over the net short-term capital loss," can only mean the total long-term capital gains unreduced by any offset. For petitioners to prevail, the statutory "excess" phrase would have to be given a unique meaning applicable only to the alternative tax computation, *i.e.*, "excess * * * reduced by the amount of such net long-term gain set aside for charity." Such a radical transformation of Section 1201(b)(2) hardly comports with this Court's oft-stated admonition that "the words of statutes—including revenue acts—should be interpreted where possible in their ordinary, everyday senses." *Crane* v. *Commissioner*, 331 U.S. 1, 6.

Indeed, in *United States* v. *Foster Lumber Co.*, 429 U.S. 32, the Court recently rejected a similar attempt by a taxpayer to depart from the plain meaning of a tax statute and to impose a special gloss only with respect to the alternative tax computation. The reasoning of *Foster Lumber Co.* should govern this case. Just as the Court refused to rewrite the statute to accommodate the special needs of a taxpayer required to employ the alternative tax computation, it should likewise refuse to cumulate the benefits of the alternative tax and the ordinary income deductions by inter-

polating a charitable contribution deduction in Section 1201(b)(2). If Congress had intended to allow a deduction from the capital gains tax base for the amount of such gains set aside for charity, it could easily have done so in plain unmistakable terms.

2. The legislative history confirms that Congress intended that the Section 1201(b)(2) capital gains tax base was not to be offset by deductions. Section 208(a)(5) of the Revenue Act of 1924 provided that under the alternative method a taxpayer could offset his capital gains base by the amount by which his ordinary deductions exceeded his ordinary income. The Revenue Act of 1934 changed the method of treating long-term capital gains and eliminated the alternative tax. But when Congress reintroduced the alternative tax computation in the Revenue Act of 1938, it redefined the capital gains base as the total net long-term capital gain without any further offset. The legislative evidence therefore clearly establishes that Congress previously accepted but has now deliberately rejected the computational method urged by petitioners in this case. There is accordingly no basis for engrafting the once-applicable provisions of the Revenue Act of 1924 back onto the present statute. Accord: *Weil* v. *Commissioner*, 23 T.C. 424, affirmed, 229 F.2d 593 (C.A. 6); *Chartier Real Estate Co.* v. *Commissioner*, 52 T.C. 346, 350-356 (Raum, J.), affirmed *per curiam*, 428 F.2d 474 (C.A. 1).

B.

Petitioners premise their claim to a charitable deduction offset entirely on the ground that an estate rather than an individual earned the capital gains in question and that estates are subject to special "conduit" rules that override the otherwise applicable requirements of the alternative tax computation. In petitioners' view, the Code considers an estate to be a "conduit" with respect to the portion of its capital gains set aside for charity, and from the very outset such gains are attributable to the charitable beneficiaries and not to the estate. They accordingly conclude that such gains can be excluded from the Section 1201(b) tax base. In support of their argument, petitioners rely upon *Statler Trust* v. *Commissioner*, 361 F.2d 128 (C.A. 2). There, although the Court acknowledged that the language of Section 1201(b) supported the government's position, it employed a conduit rationale, concluding that "the letter of § 1201 (b) must yield when it would lead to an unfair and unintended result" (361 F.2d at 131).

Contrary to the conclusion of the Second Circuit, the result is neither unfair nor unintended. The pertinent provisions of the Code effectively refute petitioners' and *Statler Trust's* assumption that capital gains set aside by an estate for charity are subject to the conduit rules under which such gains would be deductible by the estate under Section 661 as distributions of income required to be distributed currently. Section 663(a)(2) provides an explicit statutory rule

that amounts qualifying for the charitable deduction are not to be taken into account in computing an estate's distribution deduction under Section 661(a). Indeed, the fact that Section 642(c) allows an estate or trust a deduction from gross income for amounts set aside for charity shows that Congress classified such amounts as belonging to the estate or trust in the first instance and not to the charitable beneficiary.

Nor does Section 643(a)(3) support petitioners' conduit argument with respect to charitable contributions. The function of that provision is to assure that capital gains that will give rise to a charitable deduction, if set aside for charity, will be included in "distributable net income"—the maximum amount upon which the beneficiaries can be taxed. Absent such an "add-back" provision, the estate's distributable net income (which already has been reduced by the charitable contribution deduction) would not include the amount of the capital gains set aside for charity and the other current income beneficiaries would thereby be able to receive tax-free distributions to the extent of those gains.

Thus, contrary to the view of the Second Circuit in *Statler Trust*, the purpose of Section 643(a)(3) was not to subject charitable contributions to conduit treatment, but instead was to deny the benefits of the charitable deduction to other current income beneficiaries of the estate. As the court below correctly observed (Pet. App. 15), "The [*Statler Trust*] court's reliance on section 643(a)(3)'s inclusion of charitable

payments and set asides from capital gains in distributable net income to evidence a pervasive reliance on a conduit principle for such charitable provisions is misplaced. Section 643(a)(3) * * * is part of a structure which in its entirety unmistakably rejects the conduit principle for charitable payments and set asides."

ARGUMENT

THE ALTERNATIVE CAPITAL GAINS TAX COMPUTATION BY AN ESTATE UNDER SECTION 1201(b) OF THE INTERNAL REVENUE CODE PRECLUDES A DEDUCTION FROM LONG-TERM CAPITAL GAINS FOR THE AMOUNT OF SUCH GAINS SET ASIDE BY THE ESTATE FOR CHARITY

A. The language and legislative history of Section 1201(b) demonstrate that net long-term capital gains are subject to the preferential flat rate without reduction for amounts otherwise deductible against ordinary income

The question presented in this federal income tax case is technical and computational in character. It involves the operation of the provisions of the Internal Revenue Code governing the taxation of capital gains under both the "normal" (Section 1202) and the "alternative" (Section 1201) methods. These are two discrete methods for the computation of the tax on capital gains, and the Code requires that the computation producing the lesser liability be applicable. The normal method of Section 1202 has been applied without disagreement and is not the subject of the dispute in this case. However, the courts of appeals have

divided on the question of the correct amount of the Section 1201 alternative tax liability of a trust or estate that sets aside part of its long-term capital gains for charity.

The decision below held, in conformity with the analogous decisions involving an individual taxpayer in *Weil* v. *Commissioner*, 23 T.C. 424, affirmed, 229 F.2d 593 (C.A. 6), and a corporate taxpayer in *Chartier Real Estate Co.* v. *Commissioner*, 52 T.C. 346, 350-356 (Raum, J.), affirmed *per curiam*, 428 F.2d 474 (C.A. 1),[6] that the long-term capital gains base subject to the preferential flat 25 percent rate in the alternative tax computation could not be reduced by amounts otherwise deductible against ordinary income. It therefore concluded that petitioners, who are executors of an estate,[7] could not, in the alternative computation, reduce the estate's long-term capital gains by the amount of such gains set aside for charity pursuant to the terms of the will. In so ruling, the court rejected the contrary decision of the Second Circuit in *Statler Trust* v. *Commissioner*, 361 F.2d 128.

We submit that the court below correctly held that the net long-term capital gains base cannot be

[6] The second issue in *Chartier Real Estate Co.*, involving the amount of a loss carryover available after a carryback to a year in which the alternative tax was applicable, was resolved in favor of the government by this Court's decision in *United States* v. *Foster Lumber Co.*, 429 U.S. 32.

[7] We use the term "petitioners" to refer to the Disney Estate.

offset by a charitable contribution deduction under the alternative tax computation. Both the language of the statute and its legislative history confirm that Congress intended that net long-term capital gains were to be fully subject to the alternative 25 percent tax without any reduction for amounts that would be deductible in the regular computation of taxable income. Indeed, as we shall show, the structure of the statute demonstrates that such deductions (such as the deduction for charitable contributions) come into play only when the ordinary progressive rates are applied against the resulting tax base. But under the alternative tax computation, the net long-term capital gains base is not subject to the progressive rates but to a preferential flat 25 percent rate that is designed to operate as an upper limit on the taxation of such gains. That flat rate is an alternative benefit that cannot be claimed in tandem with the deductions available when the tax at ordinary rates is applicable. Hence, there is no justification for petitioners' attempt to reduce the base upon which the preferential rate is imposed and thereby cumulate the benefits of the charitable contribution deduction and the alternative tax.

1. *The language of the statute*

a. As indicated *supra*, pp. 3-4, the Internal Revenue Code provides noncorporate taxpayers with two methods of computing the tax on capital gains.[8] Under

[8] There is also an alternative tax computation for corporations provided by Section 1201(a).

the normal method of Section 1202, the taxpayer is permitted a deduction from gross income equal to 50 percent of the net long-term capital gains.[9] After further subtraction of "the [other] deductions allowed by this chapter" to arrive at "taxable income" as defined by Section 63(a), the resulting figure is subject to tax at the regular progressive rates.

Section 1201(b) prescribes an alternative tax for non-corporate taxpayers on the excess of the net long-term capital gains over the net short-term capital losses. This alternative tax is an exception to the graduated income tax imposed by Sections 1 and 641 of the Code upon non-corporate taxpayers such as individuals, estates, and trusts. As Section 1201(b) provides, the alternative tax is "in lieu of the tax imposed by sections 1 and 511, * * * (if such tax is less than the tax imposed by such sections)." Thus, if a taxpayer has income from capital gains, he is required to compute his tax under both Sections 1 and 1201 (b) and employ whichever method yields the lower liability.

The mechanics of the Section 1201(b) alternative tax computation involve a two-step process. Section 1201(b) provides that the alternative tax is the sum of—

> (1) a partial tax computed on the taxable income reduced by an amount equal to 50 percent of [the excess of the net long-term capital gain over the net short-term capital loss], at the rate

[9] See p. 10, n. 5, *supra*.

> and in the manner as if this subsection had not been enacted, and
>
> (2) an amount equal to 25 percent of the excess of the net long-term capital gain over the net short-term capital loss.

Under the first step of the statutory formula, a partial tax is computed on the taxable income reduced by 50 percent of the net long-term capital gains [10] at the regular rates imposed by Section 1. Since the taxable income already reflects the Section 1202 deduction of 50 percent of net long-term capital gains available under Section 1202, the consequence of the second 50 percent deduction is effectively to exclude the net long-term capital gains from the computation of the partial tax.[11] The alternative tax is the sum of the partial tax and the 25 percent tax on long-term capital gains. Thus, if a taxpayer had net long-term capital gains sufficient to subject part of his income to tax at incremental rates greater than 50 percent under the regular computation, he would be required to use the alternative tax.

In this case, it is undisputed that petitioners' taxable income for 1967 was approximately $146,000 (see

[10] See p. 10, n. 5, *supra*.

[11] Strictly speaking, the Section 1201(b)(1) "partial" tax base is taxable income less 50 percent of the excess of net long-term capital gains over net short-term capital losses. That base would therefore include net short-term capital gains for 1966 and only a small amount ($16,944.16) for 1967, we have for convenience referred to the Section 1201(b)(1) partial tax base as "net ordinary income."

• However, because petitioner had no short-term capital gains

p. 6, *supra;* Ex. B, p. 1, A. 35). This figure represents petitioners' gross income of $595,000 (including $500,000 of long-term capital gains) minus allowable deductions, including the charitable contribution deduction and the Section 1202 deduction equal to 50 percent of their net long-term capital gains ($500,000 divided by 2 = $250,000). However, when petitioners computed their tax liability under the alternative method, they turned about and adopted an entirely different assumption with respect to the treatment of their long-term capital gains. For these purposes, petitioners assumed that they had only $275,000 of long-term capital gains, *i.e.*, the difference between $500,000 and the $225,000 of such gains set aside for charity. In petitioners' view, they never received the $225,000 that was set aside for charity pursuant to the terms of Disney's will. As a result, in computing the partial tax base under step 1 of the alternative method, petitioners reduced their $146,000 taxable income (which already reflected the allowable charitable contribution deduction) by a 50 percent deduction of $137,500 (($500,000 minus $225,000) divided by 2). This computation resulted in a partial tax base of $8,500 ($146,000 minus $137,500). Moreover, they claimed that the amount of long-term capital gain subject to the 25 percent flat rate was $275,000 ($500,000 minus $225,000), rather than $500,000.

But the language of the statute does not permit such varying assumptions as to the includability of long-term capital gains. To the contrary, it provides

a uniform verbal formula for the computation of long-term capital gains that is unaffected by the amount of such gains set aside for charity, or, indeed, any other deduction that might otherwise be available as an offset against income. Sections 1202, 1201 (b) (1) and 1201 (b) (2) all speak of the "excess of the net long-term capital gain over the net short-term capital loss."[12] Thus, for any given taxable year, that statutory element is a constant that does not vary in accordance with whether the taxpayer is computing the normal tax with the Section 1202 deduction, or the alternative tax as the sum of the partial tax and the flat 25 percent tax on long-term capital gains. For 1967, the statutory "excess of the net long-term capital gain over the net short-term capital loss" for all purposes is therefore $500,000, and not $500,000 minus $225,000, as petitioners would have it.

b. Moreover, the statutory phrase "excess of the net long-term capital gain over the net short-term capital loss" is not susceptible to varying interpretations. If, as is the case here, a taxpayer has no short-term capital losses, the "excess"—which constitutes the Section 1201 (b) (2) capital gains base upon which the flat 25 percent tax is computed—can only be the net long-term capital gains unreduced by any offset.

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[12] Strictly speaking, the quoted phrase is found only in Section 1201 (b) (2). However, both Sections 1201 (b) (1) and 1202 address the case where "the net long-term capital gain exceeds the net short-term capital loss," and use the term "such excess." Thus, all three provisions refer to the same quantitative "excess."

For petitioners to prevail, the statutory "excess" phrase would have to be given a unique meaning applicable only to the alternative tax computation, *i.e.*, "excess * * * reduced by the amount of such net long-term gain set aside for charity." Such a radical transformation of Section 1201(b)(2) hardly comports with this Court's oft-stated admonition that "the words of statutes—including revenue acts—should be interpreted where possible in their ordinary, everyday senses" (footnote omitted). *Crane* v. *Commissioner*, 331 U.S. 1, 6. See also *Malat* v. *Riddell*, 383 U.S. 569, 571; *Hanover Bank* v. *Commissioner*, 369 U.S. 672, 687-688; *Commissioner* v. *Korell*, 339 U.S. 619, 627-628; *United States* v. *Consumer Life Ins. Co.*, 430 U.S. 725, 740-741.

Indeed, only two Terms ago in *United States* v. *Foster Lumber Co.*, 429 U.S. 32, the Court rejected a similar attempt by a taxpayer to depart from the plain meaning of a tax statute and impose a special gloss with respect to the alternative capital gains tax computation. There, the question was to what extent a loss carryback was "absorbed" in a prior year in which the alternative method was applicable. The pertinent statute, Section 172(b)(2), provided that the amount of the loss carryback available for use in future years was "the excess, if any, of the amount of such loss over the sum of the taxable income for each of the prior taxable years to which such loss may be carried." Since Section 63(a) defines the term "taxable income" to include both ordinary income and capital gains, the Court concluded that the "excess" in Section 172(b)(2) was the amount of the carryback over the sum of ordinary income *and* capital gains, and not simply ordinary income, as the taxpayer urged. In so holding, the Court stated, in terms that apply with equal force here (429 U.S. at 41):

> It is, of course, not unusual in statutory construction to find that a defined term's meaning is substantially modified by an attached clause. But reading "taxable income to which . . . such loss may be carried" as equivalent to "taxable income to which such loss may be carried and deducted, resulting in a reduction of tax liability" gives these phrases a synergistic effect that goes well beyond their natural import. Such a construction subtly redefines "taxable income" in terms of the tax impact of a particular method of tax calculation. It thus implicitly departs from the "term of art" definition of taxable income given in § 63(a), while discovering a significance in the word "carry" that goes well beyond its usual connotation of a transfer of a loss from the year in which it occurred. * * * If Congress had intended to allow a loss deduction to offset only ordinary income when the alternative tax calculation method is used, it could easily have said so.

The reasoning of *Foster Lumber Co.* should govern this case. Just as the Court refused to redefine "taxable income" to accommodate the special needs of a taxpayer required to employ the alternative tax com-

putation, it should likewise refuse to cumulate the benefits of the alternative tax and the ordinary income deductions by interpolating a charitable contribution deduction into the statutory phrase "excess of the net long-term capital gain over the net short-term capital loss." "Since the statutory language seems rather plain in both * * * [Sections 1202 and 1201(b)], * * * [the courts] have the same duty in both to resist the temptations to attempt any creative rewriting of the Internal Revenue Code." *United States* v. *Foster Lumber Co., supra*, 429 U.S. at 49 (Stevens, J., concurring). Surely if Congress had intended to allow a deduction from the Section 1201(b)(2) capital gains base for the amount of such gains set aside for charity, it could easily have so provided in plain unmistakable terms.

c. Finally, the structure of Section 1201(b) refutes petitioners' claimed reduction of the capital gains base by the amount of such gains set aside for charity. As we have pointed out *supra*, pp. 18-19, the partial tax base of Section 1201(b)(1) is computed by subtracting 50 percent of the net long-term capital gains from "taxable income" so as to isolate the net ordinary income subject to the graduated rates. But "taxable income," as defined by Section 63(a), is "gross income, minus the deductions alowed by this chapter * * *." Hence, the partial tax base already reflects the deduction for amounts set aside for charity, as well as all other allowable deductions.

In contrast, however, the capital gains base is "the excess of the net long-term capital gain over the net

short-term capital loss." Thus, the statutory scheme allocates all of the allowable deductions to the Section 1201(b)(1) ordinary income partial tax base and none to the Section 1201(b)(2) capital gains base. As a result, there is no justification for shifting deductions from the partial tax base to the capital gains base simply because those deductions may be "wasted" to the extent they exceed the taxpayer's gross ordinary income (see Pet. App. 8). Indeed, the Court rejected much the same claim by the taxpayer in *Foster Lumber Co.* that the loss carryover deduction should not be "wasted" in the context of the alternative tax computation, observing that "Congress has not hesitated in this area to limit taxpayers to the enjoyment of one tax benefit even though it could have made them eligible for two " (429 U.S. at 45-46).

Here, the alternative flat rate on the capital gains base is a benefit that stands on its own independent footing and cannot be cumulated with the deduction for charitable contributions that comes into play only when the ordinary tax rates are applicable. As the dissenting judge in *Statler Trust* v. *Commissioner*, *supra*, 361 F.2d at 133, aptly stated: "The statute's effect is too plain to be supposed an inadvertent one, and it is far from being ungenerous. The alternatives are payment of tax at ordinary rates on half the capital gain less the adjusted deduction for the part of it paid to charity or paying a tax on that same income amount equal to a quarter of the total capital gain."

2. *The legislative history*

a. The legislative history confirms that Congress intended the statutory phrase "excess of the net long-term capital gain over the net short-term capital loss" to mean precisely what it says, *viz.*, the entire amount of long-term capital gain unreduced by amounts that might otherwise be allowable as offsets against ordinary income.

Prior to the Revenue Act of 1921, 42 Stat. 227, capital gains were taxed in the same manner as other income. However, in 1921, Congress introduced the capital gain concept and an alternative method of computing tax on capital gain for individuals at the election of the taxpayer. That method, essentially identical to the alternative computation provided by Section 1201 of the present Code, prescribed a partial tax on net ordinary income (net income exclusive of capital gain) computed at regular progressive rates, plus 12½ percent of "capital net gain," which was defined as the excess of capital gain over capital deductions and losses. See Revenue Act of 1921, Sections 206(a)(4) and (5) and 206(b). But in Section 208(a)(5) of the Revenue Act of 1924, 43 Stat. 262, the term "capital net gain" was redefined to mean—

> the excess of the total amount of capital gain over the sum of (A) the capital deductions and capital losses, plus (B) *the amount, if any, by which the ordinary deductions exceed the gross income computed without including capital gain* * * *. [Emphasis supplied.]

The purpose of this amendment was to provide relief for taxpayers whose deductions exceeded their ordinary income but whose capital gains would still be fully subject to the flat 12½ percent tax. The Act therefore permitted the offset of such excess deductions against the capital gains base. As the House Committee (H.R. Rep. No. 179, 68th Cong., 1st Sess. 19 (1924)) explained—

> Under the existing law the tax under the capital gain section is the tax on the ordinary net income plus 12½ percent of the capital gain. If the taxpayer has no ordinary net income but has a deficit, the tax under the existing law is still 12½ percent of the capital gain, although the capital gain may thus be in excess of the net income of the taxpayer. In the bill paragraph (4) is inserted, and the two succeeding paragraphs are changed in order to revise the definition of capital net gain so that *the tax in cases where there is a deficit in ordinary income will be 12½ percent of an amount determined by subtracting from the capital net gain the amount of the deficit in ordinary net income. This provision is in the interest of the taxpayer.* [Emphasis supplied.]

The identical provision was reenacted by Section 208(a)(5) of the 1926 Act, 44 Stat. 19, and by Section 101(c)(5) of the 1928 and 1932 Act, 45 Stat. 811 and 47 Stat. 191. The Revenue Act of 1934, however, eliminated the alternative tax on capital gains. Section 117(a) of that Act, 48 Stat. 714, instead pro-

vided that certain percentages [13] of the gain or loss recognized upon the sale or exchange of a capital asset "shall be taken into account in computing net income." Thus, under the 1934 Act (and the 1936 Act as well), the appropriate percentages of capital gain were included in gross income from which deductions were subtracted in determining net income. The tax was levied on the resulting figure at the regular graduated rates. Under these statutes, the taxpayer's deductions could be used to reduce that portion of the capital gain that was taken into account in determining gross income.

Section 117(b) of the Revenue Act of 1938, 52 Stat. 501, continued the inclusion of varying percentages of capital gains on gross income offset by the allowable deductions. However, Section 117(c) of that Act reintroduced the alternative tax in a different form that is the direct predecessor of Section 1201 of the present Code. Section 117(c)(1) of the 1938 Act provided (emphasis supplied):

> A partial tax shall first be computed upon the net income reduced by the amount of the net long-term capital gain, at the rates and in the manner as if this subsection had not been enacted, and the total tax shall be the partial tax *plus 30 per centum of the net long-term capital gain.*

Section 117(a)(8) of the Act defined the term "net long-term capital gain" as "the excess of long-term

[13] The percentages ranged from 100 percent, if the capital asset had been held for not more than one year, to 30 percent if held for more than 10 years.

capital gains for the taxable year over the long-term capital losses for such year."

Thus, unlike the alternative tax of the Revenue Act of 1924, which permitted the excess of ordinary deductions over ordinary income to be offset against capital gains, the 1938 Act did not permit any offset against capital gains by the excess "unused" ordinary deductions. To the contrary, it redefined the capital gains base as the total long-term capital gains minus the long-term capital losses without any further offset, thereby insuring that the total alternative tax would be "computed on the net income of the taxpayer exclusive of such long-term capital gain, at the regular rates, plus 30 per cent of the net long-term capital gain." H.R. Rep. No. 2330, 75th Cong., 3d Sess. 43 (1938).

This method of computing the alternative tax was carried forward in Section 117(c) of the 1939 Code and in Section 1201 of the 1954 Code. As the House Committee reporting out the current measure explained, "[t]his section is derived from section 117(c) of present law which provides the alternative tax on capital gains. No substantive change is intended although several wording changes have been adopted for simplification. The computation of the alternative tax is described in two steps rather than three." H.R. Rep. No. 1337, 83d Cong., 2d Sess. A273 (1954). See also S. Rep. No. 1622, 83d Cong., 2d Sess. 431 (1954).

The foregoing legislative history convincingly refutes petitioners' claim to an offset from their net

capital gains in the amount of such gains set aside for charity. When Congress reintroduced the alternative tax in 1938, it changed the law from the 1924 version by broadening the capital gains base to include the total net long-term capital gains unreduced by any deductions otherwise allowable against ordinary income. The legislative evidence therefore clearly establishes that in 1924 Congress accepted but since 1938 has deliberately rejected the computational method urged by petitioners in this case. There is accordingly no basis for engrafting the once-applicable provisions of the Revenue Act of 1924 back onto the present statute when both the language and history point decisively in the opposite direction.

b. Our reading of the legislative history of Section 1201 is supported by all of the courts that have considered it. In *Weil* v. *Commissioner*, *supra*, an individual taxpayer's statutory deductions, including, *inter alia*, charitable contributions, exceeded his ordinary income, as distinguished from taxable capital gain. Like petitioners, the taxpayer in *Weil* claimed that his unused deductions (*i.e.*, the deficit in ordinary income) could be deducted from the taxable capital gain in computing the capital gain portion of the alternative tax. However, after considering the above-described legislative history, both the Tax Court (in a unanimous reviewed decision) and the Sixth Circuit concluded that the capital gain portion of the alternative tax under Section 117(c) of the 1939 Code is a flat rate of tax upon the total capital gains

unreduced by the amount of unused deductions. As the Tax Court observed (23 T.C. at 430-431):

> We thus believe that Congress intended that the 50 per cent rate be applied to the same amount in computing the capital gain portion of the alternative tax as was included in gross income in computing the regular tax. This express language of the statute carries out the intention of the framers of the 1938 Act * * * that a flat rate of tax on taxable capital gain be an alternative to the tax imposed upon such gain when it is included in gross income and taxed in the regular manner. Petitioners have not pointed out, and we are unable to find, anything in the language of the Code to indicate that Congress intended to include one amount in gross income for the regular tax computation but to apply the flat 50 per cent rate to some other amount under the alternative tax.[14]

See also Rev. Rul. 56-247, 1956-1 Cum. Bull. 383.

Moreover, in *Chartier Real Estate Co.* v. *Commissioner*, *supra*, the Tax Court reaffirmed its holding in

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[14] Although the flat rate on net capital gains is 25 percent under Section 1201(b) of the 1954 Code for the years involved here, as contrasted with the 50 percent rate under Section 117(c)(2) of the 1939 Code applicable in *Weil*, the result would be the same under either statute. Under Section 1201(b), the 25 percent rate is applied to the entire excess of net long-term capital gain over net short-term capital loss, while under Section 117(c)(2) of the 1939 Code (as it stood in 1948, the year involved in *Weil*), only 50 percent of the capital gain was taken into account for this purpose. In *Weil*, the Tax Court noted the variant statutory mechanisms (23 T.C. at 431 n. 1).

Weil and applied it to the essentially identical alternative tax for corporations provided by Section 1201 (a) of the 1954 Code. There, as here, the taxpayer sought to offset its net capital gains against a deficit in ordinary income. But Judge Raum found no basis in the language of the statute for such an offset, observing that "[w]e refused in *Weil* to engraft such a limitation onto the plain words of the statute, and we refuse to do so here" (52 T.C. at 352). Moreover, the court adhered to its prior analysis of the legislative history. "The conclusion drawn from this history in *Weil* and here is that since the 1924 Act specifically provided for the application of a deficit in ordinary income to capital gain in computing the capital gains portion of the tax, the absence of such a provision in the 1939 and 1954 Codes is of significance and prevents our reading in such a provision, for Congress knew how to deal with the problem when it wished to" (*id.* at 353). See also *United States* v. *Foster Lumber Co.*, *supra*, 429 U.S. at 38 and and n. 5, 47 and n. 17, 49 and n. 2 (Blackmun, J., dissenting); *Pope & Talbot, Inc.* v. *Commissioner*, 60 T.C. 74, affirmed *per curiam*, 515 F.2d 155 (C.A. 9).

B. There is no exception for estates or trusts from the rule of Section 1201(b) that net long-term capital gains are subject to tax without reduction for amounts set set aside for charity

1. a. Petitioners do not dispute that the language of Section 1201(b) and its legislative history preclude a reduction in the capital gains base by the amount of

such gains set aside for charity. Nevertheless, they premise their claim to such an offset entirely on the ground that an estate rather than an individual earned the capital gains in question, and that estates are subject to special rules that override the otherwise applicable requirements of the alternative tax computation. In petitioners' view, the Code considers the Disney Estate as a "conduit" with respect to the portion of its capital gains set aside for charity, and that from the very outset such gains are attributable to the charitable beneficiaries and not to the estate. Petitioners urge that under the conduit rule, the estate never "owned" the gains it set aside for charity so that such amounts are properly excludable from its tax base. They would therefore simply eliminate the capital gains set aside for charity from both steps of the alternative computation. In support of their argument, petitioners principally rely upon *Statler Trust* v. *Commissioner*, *supra*. There, the Second Circuit employed a "conduit" rationale and held that a trust could reduce its Section 1201(b) capital gains base by the amount of such gains set aside for charity.[15]

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[15] Petitioners argue (Br. 12-13) that Congress "must be deemed to have approved and adopted the Second Circuit's decision * * *" because Congress has twice amended both Sections 642(c) and 1201(b) since that decision. But the doctrine of legislative reenactment upon which petitioners rely requires a settled judicial construction of a statute, not a single lower court decision. At all events, there is no evidence that Congress ever addressed the *Statler Trust* decision.

But petitioners' claim that charitable "set asides" are subject to "conduit" tax treatment so that an estate need not include such amounts in income does not withstand careful scrutiny of the pertinent provisions of Subchapter J (Sections 641-691) of the Code. Under the system of taxation established by the 1954 Code, estates and trusts are generally regarded as conduits through which income flows to the beneficiaries; they are considered to be separate taxable entities only to the extent that they accumulate income for future distribution. The estate receives a deduction for amounts of income and any other amounts required to be distributed currently (Section 661), and the amounts so distributed are in turn includable in the gross income of the beneficiaries (Section 662). See generally *Freuler* v. *Helvering*, 291 U.S. 35, 41-42.

In order to implement this new system, Congress introduced the concept of "distributable net income" to serve as the ceiling of the estate's distribution deduction and the amount upon which the beneficiaries may be taxed and to determine the character of amounts distributed to the beneficiaries. Thus, Section 643(a) defines "distributable net income" as "taxable income" with certain adjustments (such as inclusion of tax-exempt interest) in order to permit the taxation of beneficiaries with respect to items that would not be includable in the estate's gross income but which may be available for distribution to the beneficiaries. In turn, the beneficiaries are entitled to

claim the benefits of statutory exclusions applicable to the proportionate share of their distribution deemed to retain the character of tax-exempt income. Section 662(b). See generally S. Rep. No. 1622, *supra*, at 343-345.

The fundamental error in petitioners' position and that of the Second Circuit in *Statler Trust* is the assumption that capital gains set aside by an estate for charity are subject to the conduit rules of Sections 661 and 662. To the contrary, Section 663(a)(2) explicitly provides a special rule that amounts qualifying for the charitable deduction are not to be taken into account in computing an estate's distribution deduction (Section 661(a)) and the amount required to be reported by the beneficiaries as distributable income (Section 662(a)). The special rule of Section 663(a)(2) states: "There shall not be included as amounts falling within section 661(a) or 662(a)— * * * (2) * * * Any amount paid or permanently set aside or otherwise qualifying for the [charitable] deduction provided in section 642(c) * * *." Thus, Congress undisputedly placed such charitable set-asides outside the ambit of the conduit rules pursuant to which the estate deducts and the beneficiaries include in gross income all income required to be distributed currently. As the Senate Finance Committeed observed with respect to the special rule of Section 663(a)(2), "[s]ince the estate or trust is allowed a deduction under Section 642(c) for amounts paid, permanently set aside, or otherwise qualifying for the

deduction provided in that section, such amounts are not allowed as an additional deduction for distributions, nor are they treated as amounts distributed for purposes of section 662 in determining the amounts includible in gross income of the beneficiaries." S. Rep. No. 1622, *supra*, at 354.[16]

Moreover, the fact that Section 642(c) allows an estate or trust a deduction from gross income for amounts set aside for charity shows that Congress classified amounts of income paid by an estate or trust to charity as belonging to the estate or trust in the first instance and not to the charitable beneficiary. Thus, contrary to petitioners' contention (Pet. 17-18 n. 14), the availability of a statutory charitable deduction from the gross income of a trust or estate means that the deductible item is *not* within the conduit rules. Only those items that are deductible as distributions under Sections 651 and 661 are subject

[16] The Second Circuit in *Statler Trust* refused to regard Section 663(a)(2) as evidence of Congress' intention to classify charitable contributions outside the operation of the conduit rules. In its view, Section 642(c) provides for a special unlimited charitable deduction applicable to trusts and "Congress enacted § 663(a)(2) to prevent the trust from having a double deduction and a beneficiary from claiming a charitable deduction already taken by the trust" (361 F.2d at 132). But this point does not detract from our argument that Section 663(a)(2) places charitable set asides outside the conduit rules. Taken together, Sections 642(c) and 663(a)(2) show that Congress chose to regard the charitable set aside as a charitable rather than as a distribution deduction of the trust. Thus, the capital gains that are the subject of the charitable set aside are attributable to the trust and not the beneficiary.

to conduit treatment. Petitioners therefore err in arguing (Br. 15-18) that Section 642(c) manifests a conduit principle with respect to charitable contributions. That provision simply permits the trust or estate a deduction against its own income—a treatment under the Code directly contrary to that of a conduit. Unlike Section 661, it does not treat charitable contributions as distributions already in the hands of the recipients, and unlike Section 662, it does not deem such amounts as received by the charity.[17]

b. Acknowledging that Section 663(a)(2) presents a formidable statutory obstacle to their argument that capital gains set aside by an estate for charity are subject to the conduit rules, petitioners contend (Br. 17-18), in accordance with the Second Circuit's observation in *Statler Trust*, that "Congress considered charitable contributions from capital gains to be generally within the conduit principle, as demonstrated by their inclusion in the definition of distributable net income in § 643(a)(3)" (footnote omitted) (361 F.2d at 131). Section 643(a)(3), the provision to which the court referred, includes in the distributable net income of an estate or trust capital

[17] There have been proposals, which, if enacted, would have treated charitable contributions as *distributions* by the estate. See Sections 102(b), 103, 106, 107 and 108(a) of H.R. 9662, 86th Cong., 2d Sess. (1960); H.R. Rep. No. 1231, 86th Cong., 2d Sess. 10 (1960). The bill provided for repeal of the Section 642(c) charitable deduction, and proposed to replace it with a mechanism under which such amounts would be treated as distributions.

gains set aside for charity. See Treasury Regulations, Section 1.643(a)-3(a) (26 C.F.R.).

But the inclusion of such gains in distributable net income does not establish that they are subject to the conduit rules of Sections 661 and 662. The add-back provisions of Section 643(a)(3) are one of a series of modifications to the taxable income of an estate or trust to arrive at "distributable net income." See Section 643(a)(1) through (7). Since the concept of distributable net income is used to determine the maximum amount upon which the beneficiaries can be taxed, it was "necessary to adjust the taxable income of an estate or trust by adding to it items of trust income which are not includible in the gross income of the estate or trust but which may nevertheless be available for distribution to the beneficiaries." S. Rep. No. 1622, *supra*, at 343. Section 643(a)(3) therefore includes the capital gains set aside for charity in distributable net income in order to prevent a non-charitable beneficiary from deriving an advantage from the estate's charitable deduction. Absent the add-back provisions of Section 643(a)(3), the estate's distributable net income would not include the capital gains set aside for charity and would therefore enable the current income beneficiaries to receive tax-free distributions from the estate to the extent of the amount of those gains.[18] Thus, contrary to the view

[18] This point can be demonstrated by the following example. Suppose an estate has ordinary gross income of $60,000 and net long-term capital gains of $40,000. Pursuant to the will, the entire $40,000 is distributed to charity. Under Section 643(a), distributable net income is $100,000 ($60,000 ordinary income + $40,000 capital gains — $40,000 charitable contribution + $40,000 capital gains add-back). Thus, if the estate distributed $100,000 to its current income beneficiaries Section 643(a)(3) insures that they will be taxable on the full distribution despite the fact that the estate's taxable income was $60,000. The effect of the capital gains "add-back" is to prevent the current income beneficiaries from taking advantage of the estate's charitable deduction by limiting their taxable distribution to $60,000.

of the Second Circuit in *Statler Trust*, the purpose of Section 643(a)(3) was not to include an estate's charitable payments within the conduit principle but to deny the benefits of the charitable contribution deduction to the current income beneficiaries of the estate. Section 643(a)(3) therefore provides no support for petitioners' claimed offset against their capital gains base. As the court below properly concluded, "[t]he [*Statler Trust*] court's reliance on section 643(a)(3)'s inclusion of charitable payments and set asides from capital gains in distributable net income to evidence a pervasive reliance on a conduit principle for such charitable provisions is misplaced. Section 643(a)(3) * * * is part of a structure which in its entirety unmistakably rejects the conduit principle for charitable payments and set asides" (Pet. App. 15).[19]

[19] Contrary to the assumption of the Second Circuit in *Statler Trust* (361 F.2d at 131), the statutory rules are different for capital gains set aside for non-charitable beneficiaries. In that case, the gains are subject to conduit treatment. The second sentence of Section 1202 requires that such gains be included in the income of the recipient beneficiary under Sections 652 and 662, and the beneficiary is entitled to claim the

Finally, there is other statutory evidence that Congress intended to exclude charitable beneficiaries from the conduit structure. Section 662(a)(1) provides that current income beneficiaries must compute distributable net income without regard to the trust's charitable deduction (and thereby increase their tax base) whenever amounts of income required to be distributed currently exceed distributable net income as so computed. By eliminating the charitable deduction from the computation of distributable net income for this purpose, the Code refutes petitioners' claim that the capital gain set aside for charity should simply not be considered. See Treasury Regulations, Section 1.662(a)-2, particularly Section 1.662(a)-2(e), Exs. (1) and (2); S. Rep. No. 1622, *supra*, at 349. For if petitioners were correct in their assertion that capital gains set aside for charity should be eliminated from the estate's tax base, the estate would have had no charitable deduction for such gains and there would

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50 percent deduction of the Section 1202 normal tax computation. See Treasury Regulations, Section 1.1202-1(b). The trust would correspondingly treat the payment as a deductible distribution under Section 661. It is therefore clear that Congress carefully distinguished between capital gains set aside for charitable and non-charitable beneficiaries, and provided for conduit treatment only in the latter case. Indeed, petitioners' computation of the Disney Estate's normal tax implicitly recognizes that capital gains set aside for charity are not subject to conduit treatment since they claimed the Section 642(c) charitable deduction on behalf of the trust. See pp. 19-20, *supra*.

have been no need for Congress to have provided the special computational rule of Section 661(a)(1). Thus, Section 661(a)(1) cannot be reconciled with petitioners' attempt to remove capital gains set aside for charity on the basis of a conduit theory.[20]

2. Contrary to petitioners' further argument (Br. 25-27), the decisions permitting a deduction under Section 691(c) for estate taxes allocable to income in respect of a decedent against long-term capital gains do not support their claimed charitable contribution offset against their capital gains base. In those cases,[21] a decedent's estate earned capital gains upon the sale of capital assets. It included the value of the capital assets in the gross estate for estate tax purposes and also paid income tax upon the capital gains received from their sale. In computing its capital gains tax under the alternative method, it claimed a deduction

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[20] Section 662(a)(2) and (b) are also inconsistent with petitioners' exclusion of charitable set-asides from an estate's income. Under Section 662(a)(2), non-current income beneficiaries are entitled to take the trust's charitable deduction into account in computing distributable net income. Likewise, under Section 662(b), which provides an allocation formula for determining the character of amounts distributed to the beneficiaries, the charitable deduction is taken into account. See Treasury Regulations, Section 1.662(b)-2.

[21] See, *e.g.*, *Read* v. *United States*, 320 F.2d 550 (C.A. 5); *Meissner* v. *United States*, 364 F.2d 409 (Ct. Cl.); *Estate of Sidles* v. *Commissioner*, 65 T.C. 873, *acq.* 1976-2 Cum. Bull. 2. See also *Quick* v. *United States*, 503 F.2d 100 (C.A. 10); *Goodwin* v. *United States*, 458 F.2d 108 (Ct. Cl.).

under Section 691(c) from the Section 1201(b)(2) capital gains tax in the amount of estate tax attributable to the inclusion of the capital assets in the gross estate. Despite the fact that Section 1201(b)(2) does not literally permit a Section 691(c) deduction for estate taxes paid on income in respect of a decedent, the courts upheld the deduction. Petitioners urge that a similar departure from the terms of Section 1201(b) is required here.

But the decisions allowing a Section 691(c) deduction from the Section 1201(b) capital gains base turn on the particularized nature of the Section 691(c) deduction. As the Fifth Circuit in *Read* explained, the purpose of the Section 691(c) deduction is to prevent the imposition of estate tax and income tax on the full amount of the income claims of a decedent. For if the income had been received by the decedent prior to his death, the estate tax would be levied on the amount realized reduced by the income taxes attributable to it. See S. Rep. No. 1622, *supra*, at 87-89; H.R. Rep. No. 1337, *supra*, at 64-65. In the case of a decedent whose gross estate includes claims to income (income in respect of a decedent) upon which estate and income taxes must be paid, Section 691(c) permits a deduction for the estate tax attributable to the inclusion in the gross estate of the claims to income. Thus, in order to implement the congressional policy against double taxation, the courts have permitted the Section 691(c) deduction to come into play

in the alternative tax computation (see 320 F.2d at 553).

Here, however, there are no considerations of double taxation that would justify reduction of the capital gains base by the amount of the charitable contribution. As the court of appeals correctly observed, "[i]n holding as we do we do not subject capital gains to double taxation nor do we eliminate the effectiveness of the charitable contribution for estates and trusts. While we do preclude the reduction of the flat tax on capital gains in calculating the alternative tax by refusing to permit the capital gains to be reduced by amounts paid or permanently set aside to charity, we do so in accordance with both the letter and spirit of the applicable provisions of the Code" (Pet. App. 14). The Section 691(c) authorities are therefore distinguishable.[22]

3. Finally, as further support for its decision, the Second Circuit in *Statler Trust* observed that "[t]he increase in the tax due to including such distributable

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[22] Petitioners also argue (Br. 22) that a partial distribution of the securities in kind to the Foundation followed by the sale of the securities by the Foundation would have eliminated the controversy presented by this case. That is correct. Any gains would have been those of the Foundation and not of the estate. But analysis of the matter on this hypothetical basis "would require rejection of the established tax principle that a transaction is to be given its tax effect in accord with what actually occurred and not in accord with what might have occurred." *Commissioner* v. *Nat. Alfalfa Dehydrating*, 417 U.S. 134, 148. Accord: *Central Tablet Mfg. Co.* v. *United States*, 417 U.S. 673, 690; *Frank Lyon Co.* v. *United States*, No. 76-624, decided April 18, 1978, slip op. 14-15.

gains in computing the alternative tax would have to be borne by either the charities or the remaindermen" (361 F.2d at 132). In the court's view, either possibility would "lead to an unfair or unintended result" (*id.* at 131). If the charities received a lesser distribution there would be an indirect incursion on their exempt status; to place the burden on the remaindermen would subject them to a higher tax than if the settlor had not favored charities as income beneficiaries. The court therefore distinguished the *Weil* decision on the ground that there the taxpayers made charitable gifts of gains that they themselves realized during the year (*ibid.*).[23]

But as we have pointed out *supra*, pp. 38-41, the pertinent Code provisions demonstrate in unmistakable terms that Congress intended to deny current income beneficiaries the benefits of the deduction of an estate or trust arising from distributions of capital gains to charity. It has done so (1) by requiring in Section 643(a)(3) that capital gains set aside for charity be included in distributable net income so as to increase the tax base of the non-charitable beneficiaries; and (2) by providing in Section 662(a)(1) that the amount includable in the gross income of a current income beneficiary be computed without the

[23] Petitioners further suggest (Br. 13-14 n.12) that the fact that the charitable set aside was required by the terms of the will distinguishes this case from *Weil*, where the contributions were voluntary. Suffice it to say that the Code makes no distinction between required and voluntary charitable contributions.

trust's charitable deduction when the amount of income required to be distributed currently exceeds the trust's distributable net income plus the charitable contribution deduction. Thus, to the extent that Congress addressed the question, it made a conscious choice and refused to accord non-charitable current income beneficiaries the tax benefit from income distributions made by an estate or trust to charity. As the court of appeals concluded, "[w]e are aware, of course, that any computation that reduces taxes on taxable beneficiaries because of charitable payments or set asides is directly advantageous to such beneficiaries and indirectly helpful to charities generally. While such a consideration in an exquisitely balanced situation might be controlling, the case before us is not such a situation. To permit such concerns to control here is contrary to the statute as written" (Pet. App. 15).[24]

[24] Petitioners also argue (Br. 29-37) that the Commissioner's position precluding the reduction of the capital gains base by the amount of the charitable deduction will produce "absurd" tax consequences in certain cases. Specifically, petitioners cite an example (Br. 33-34) in which the estate's ordinary income is large enough to absorb one-half of the total net long-term capital gains. Under these circumstances, the Commissioner's method will yield a lower alternative tax than petitioners' method, which petitioners attribute (Br. 31) to "a cumulative deduction equal to 150 per cent of [the] capital gains in computing the 'partial tax' under § 1201(b)(1)" (footnote omitted).

However, the fact that a different result would follow if the estate's ordinary income is sufficient to absorb one-half of the total long-term capital gains does not cast doubt upon the correctness of our position. We do not dispute that Section 1201(b) gives significance to the relative quantities of ordi-

To be sure, as petitioners argue (Br. 28, 37) and the Second Circuit observed in *Statler Trust* (361 F.2d at 132), this Court noted in a different statutory context in *Helvering* v. *Bliss*, 293 U.S. 144, 150-151, that exemptions of income devoted to charity and the reduced capital gains rate were liberalizations in the law that were not to be narrowly construed. But the Court subsequently recognized that its generalized statement in *Bliss* could not serve as the basis of decision in a case where, as here, the plain words of the statute and its legislative history pointed in the opposite direction. In terms singularly appropriate to this case, the Court stated: "Even the most liberal of constructions does not mean that statutory words and phrases are to be given unusual or tortured meanings unjustified by legislative intent or that ex-

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nary income, capital gains, and the amount of such gains set aside for charity. But in prescribing an alternative method for the computation of capital gains, Congress was free to cast that method in whatever terms it chose. Since the statute speaks of "the excess of the net long-term capital gain over the net short-term capital loss," that amount, unreduced by any offset, is available (to the extent of 50 percent) as a deduction in computing the partial tax and is fully subject to the flat tax. Indeed, petitioners' argument is essentially identical to the taxpayer's claim in *Foster Lumber Co.* that it should not be penalized as a result of the timing of its receipt of ordinary income and capital gains. In rejecting this contention on the basis of the plain words of the statute, the Court stated: "But if Congress were intent on substantially eliminating accidents of timing from the calculation of income on an average base, it would hardly have tolerated such a departure from that purpose at the very inception of the tax benefit provided by § 172" (429 U.S. at 47).

press limitations on such an exemption are to be ignored." *Better Business Bureau* v. *United States*, 326 U.S. 279, 283. See also *Commissioner* v. *Gordon*, 391 U.S. 83, 93.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

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JULY 1978.

APPENDIX

Internal Revenue Code of 1954 (26 U.S.C. (1964 ed.)):

SECTION 642. Special rules for credits and deductions.

* * * *

(c) Deduction for amounts paid or permanently set aside for a charitable purpose.

In the case of an estate or trust (other than a trust meeting the specifications of subpart B) there shall be allowed as a deduction in computing its taxable income (in lieu of the deductions allowed by section 170 (a), relating to deduction for charitable, etc., contributions and gifts) any amount of the gross income, without limitation, which pursuant to the terms of the governing instrument is, during the taxable year, paid or permanently set aside for a purpose specified in section 170 (c), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance or operation of a public cemetery not operated for profit. For this purpose, to the extent that such amount consists of gain from the sale or exchange of capital assets held for more than 6 months, proper adjustment of the deduction otherwise allowable under this subsection shall be made for any deduction allowable to the estate or trust under section 1202 (relating to deduction for excess of capital gains over capital losses). In the case of a trust, the

deduction allowed by this subsection shall be subject to section 681 (relating to unrelated business income and prohibited transactions).

* * * *

SECTION 643. Definitions applicable to subparts A, B, C, and D.

(a) Distributable net income.

For purposes of this part, the term "distributable net income" means, with respect to any taxable year, the taxable income of the estate or trust computed with the following modifications—

(1) Deduction for distributions.

No deduction shall be taken under sections 651 and 661 (relating to additional deductions).

(2) Deduction for personal exemption.

No deduction shall be taken under section 642 (b) (relating to deduction for personal exemptions).

(3) Capital gains and losses.

Gains from the sale or exchange of capital assets shall be excluded to the extent that such gains are allocated to corpus and are not (A) paid, credited, or required to be distributed to any beneficiary during the taxable year, or (B) paid, permanently set aside, or to be used for the purposes specified in section 642 (c). Losses from the sale or exchange or capital assets shall be excluded,

except to the extent such losses are taken into account in determining the amount of gains from the sale or exchange of capital assets which are paid, credited, or required to be distributed to any beneficiary during the taxable year. The deduction under section 1202 (relating to deduction for excess of capital gains over capital losses) shall not be taken into account.

(4) Extraordinary dividends and taxable stock dividends.

For purposes only of subpart B (relating to trusts which distribute current income only), there shall be excluded those items of gross income constituting extraordinary dividends or taxable stock dividends which the fiduciary, acting in good faith, does not pay or credit to any beneficiary by reason to his determination that such dividends are allocable to corpus under the terms of the governing instrument and applicable local law.

(5) Tax-exempt interest.

There shall be included any tax-exempt interest to which section 103 applies, reduced by any amounts which would be deductible in respect of disbursements allocable to such interest but for the provisions of section 265 (relating to disallowance of certain deductions).

(6) Income of foreign trust.

In the case of a foreign trust—

(A) There shall be included the amounts of gross income from sources

without the United States, reduced by any amounts which would be deductible in respect of disbursements allocable to such income but for the provisions of section 265(1) (relating to disallowance of certain deductions).

(B) Gross income from sources within the United States shall be determined without regard to section 894 (relating to income exempt under treaty).

(C) Paragraph (3) shall not apply to a foreign trust created by a United States person. In the case of a such a trust, (i) there shall be included gains from the sale or exchange of capital assets, reduced by losses from such sales or exchanges to the extent such losses do not exceed gains from such sales or exchanges, and (ii) the deduction under section 1202 (relating to deduction for excess of capital gains over capital losses) shall not be taken into account.

(7) Dividends.

There shall be included the amount of any dividends excluded from gross income pursuant to section 116 (relating to partial exclusion of dividends received).

If the estate or trust is allowed a deduction under section 642 (c), the amount of the modifications specified in paragraphs (5) and (6) shall be reduced to the extent that the amount of income which is paid, permanently set aside, or to be used for the purposes specified in section 642 (c) is deemed to consist of items specified in those

paragraphs. For this purpose, such amount shall (in the absence of specific provisions in the governing instrument) be deemed to consist of the same proportion of each class of items of income of the estate or trust as the total of each class bears to the total of all classes.

* * * *

SECTION 661. Deduction for estates and trusts accumulating income or distributing corpus.

(a) Deduction.

In any taxable year there shall be allowed as a deduction in computing the taxable income of an estate or trust (other than a trust to which subpart B applies), the sum of—

(1) any amount of income for such taxable year required to be distributed currently (including any amount required to be distributed which may be paid out of income or corpus to the extent such amount is paid out of income for such taxable year); and

(2) any other amounts properly paid or credited or required to be distributed for such taxable year;

but such deduction shall not exceed the distributable net income of the estate or trust.

* * * *

SECTION 662. Inclusion of amounts in gross income of beneficiaries of estates and trusts accumulating income or distributing corpus.

(a) *Inclusion.*—subject to subsection (b), there shall be included in the gross income of

a beneficiary to whom an amount specified in section 661(a) is paid, credited, or required to be distributed (by an estate or trust described in section 661), the sum of the following amounts:

(1) *Amounts required to be distributed currently.*—The amount of income for the taxable year required to be distributed currently to such beneficiary, whether distributed or not. If the amount of income required to be distributed currently to all beneficiaries exceeds the distributable net income (computed without the deduction allowed by section 642(c), relating to deduction for charitable etc. purposes) of the estate or trust, then, in lieu of the amount provided in the preceding sentence, there shall be included in the gross income of the beneficiary an amount which bears the same ratio to distributable net income (as so computed) as the amount of income required to be distributed currently to such beneficiary bears to the amount required to be distributed currently to all beneficiaries. For purposes of this section, the phrase "the amount of income for the taxable year required to be distributed currently" includes any amount required to be paid out of income or corpus to the extent such amount is paid out of income for such taxable year.

(2) *Other amounts distributed.*—All other amounts properly paid credited, or required to be distributed to such beneficiary for the taxable year. If the sum of—

(A) the amount of income for the taxable year required to be distributed currently to all beneficiaries, and

(B) all other amounts properly paid, credited, or required to be distributed to all beneficiaries

exceeds the distributable net income of the estate or trust, then, in lieu of the amount provided in the preceding sentence, there shall be included in the gross income of the beneficiary an amount which bears the same ratio to distributable net income (reduced by the amounts specified in (A)) as the other amounts properly paid, credited or required to be distributed to the beneficiary bear to the other amounts rpoperly paid, credited, or required to be distributed to all beneficiaries.

(b) *Character of Amounts.*—The amounts determined under subsection (a) shall have the same character in the hands of the beneficiary as in the hands of the estate or trust. For this purpose, the amounts shall be treated as consisting of the same proportion of each class of items entering into the computation of distributable net income as the total of each class bears to the total distributable net income of the estate or trust unless the terms of the governing instrument specifically allocate different classes of income to different beneficiaries. In the application of the preceding sentence, the items of deduction entering into the computation of distributable net income (including the deduction allowed under section 642(c)) shall be allocated among the

items of distributable net income in accordance with regulations prescribed by the Secretary or his delegate. In the application of this subsection to the amount determined under paragraph (1) of subsection (a), distributable net income shall be computed without regard to any portion of the deduction under section 642(c) which is not attributable to income of the taxable year.

SECTION 663. Special rules applicable to sections 661 and 662.

(a) Exclusions.

There shall not be included as amounts falling within section 661 (a) or 662 (a)—

* * * *

(2) Charitable, etc., distributions.

Any amount paid or permanently set aside or otherwise qualifying for the deduction provided in section 642 (c) (computed without regard to section 681).

* * * *

SECTION 1201. Alternative tax.

* * * *

(b) Other taxpayers.

If for any taxable year the net long-term capital gain of any taxpayer (other than a corporation) exceeds the net short-term capital loss, then, in lieu of the tax imposed by sections 1 and 511, there is hereby imposed a tax (if such tax is less than the tax imposed by such sections) which shall consist of the sum of—

(1) a partial tax computed on the taxable income reduced by an amount equal to 50 percent of such excess, at the rate and in the manner as if this subsection had not been enacted, and

(2) an amount equal to 25 percent of the excess of the net long-term capital gain over the net short-term capital loss.

* * * *

SECTION 1202. Deduction for capital gains.

In the case of a taxpayer other than a corporation, if for any taxable year the net long-term capital gain exceeds the net short-term capital loss, 50 percent of the amount of such excess shall be a deduction from gross income. In the case of an estate or trust, the deduction shall be computed by excluding the portion (if any), of the gains for the taxable year from sales or exchanges of capital assets, which, under sections 652 and 662 (relating to inclusions of amounts in gross income of beneficiaries of trusts), is includible by the income beneficiaries as gain derived from the sale or exchange of capital assets.

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No. 77-1016

UNITED CALIFORNIA BANK and LILLIAN DISNEY TRUYENS, Co-Executors of the Estate of WALTER E. DISNEY,

Petitioners,

vs.

UNITED STATES OF AMERICA,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

PETITIONERS' REPLY BRIEF.

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IN THE

Supreme Court of the United States

October Term, 1978
No. 77-1016

UNITED CALIFORNIA BANK and LILLIAN DISNEY TRUYENS, Co-Executors of the Estate of WALTER E. DISNEY,

Petitioners,

vs.

UNITED STATES OF AMERICA,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

PETITIONERS' REPLY BRIEF.

ARGUMENT.

Introduction.

The respondent's defense of its interpretation of Internal Revenue Code §1201(b) in this case is, as set forth in the Brief for the United States (hereinafter "Respondent's Brief"), based upon two contentions: first, that the statutory language of §1201(b) permits no reduction of the amount of long-term capital gains[1]

[1]The 25% tax under §1201(b)(2) is applicable, not to long-term capital gains as such, but rather to the "excess of the net long-term capital gain over the net short-term capital loss". However, in a case, such as the instant one, which involves neither long-term nor short-term capital loss it is simpler and no less accurate to refer to the 25% tax as applicable simply to long-term capital gains.

which is subject to the 25% tax under subsection 1201(b)(2); and, second, that the conduit principle has no applicability to charitable beneficiaries of estates and trusts. Both of these contentions are wholly without foundation. In asserting them, the respondent has not only misperceived the language of the statute but has disregarded its own administrative construction thereof.

I.

The Language of §1201(b) Permits the Amount of Long-Term Capital Gains Subject to the Alternative Tax to Be Reduced by the Amount of Long-Term Capital Gains Which an Estate or Trust Pays or Sets Aside for Charity.

The essence of the respondent's argument in this case is that the language of §1201(b) is capable only of that interpretation which the respondent herein seeks to place upon it and that any deviation from the statutory meaning as perceived by the respondent would constitute a "creative rewriting of the Internal Revenue Code."[2] This linguistic analysis of §1201(b) not only is more rigid than the statute requires; it also proves too much, in that it negates the respondent's own preexisting administrative interpretation of §1201(b). As that administrative interpretation demonstrates, even as construed by the respondent the language of §1201(b) does not constitute the linguistic straitjacket for which the respondent in this case contends.

The function of §1201(b) is to prescribe the alternative tax on long-term capital gains for all non-corporate taxpayers. As discussed more fully in Petitioners' Opening Brief,[3] this alternative tax consists of two components: first, a partial tax, computed under §1201(b)(1) and designed to equal the income tax which would be imposed on the taxpayer's ordinary net income (*i.e.*, the taxpayer's net income exclusive of long-term capital gains); second, the tax on long-term capital gains, computed under §1201(b)(2) as "an amount equal to 25 percent of the excess of the net long-term capital gain over the net short-term capital loss." The respondent in this case contends that the language of §1201(b), in referring to such "excess", is not susceptible of any interpretation which would permit such "excess" to be reduced by any offset. According to the respondent, the statutory language "provides a uniform verbal formula . . . unaffected by the amount of such gains set aside for charity, or, indeed, any other deduction that might otherwise be available as an offset against income."[4] The respondent's mechani-

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[2]Respondent's Brief at p. 24, quoting *United States v. Foster Lumber Co.*, 429 U.S. 32 at 49 (Stevens, J., concurring).

[3]Petitioners' Opening Brief, footnote 4 at p. 4, footnote 7 at p. 6.

[4]Respondent's Brief, pp. 20-21.

Respondent attempts to support the construction of §1201(b) for which it contends in this case by appealing to the legislative history of the alternative tax. (Respondent's Brief, pp. 26-32.) That legislative history may well support the result reached in the case of *Walter M. Weil* (1954), 23 Tax Ct. 424, aff'd (6th Cir. 1956), 229 F.2d 593, which involved an excess of the taxpayer's ordinary deductions over his ordinary income. It is not, however, relevant to the question of whether the amount of long-term capital gains subject to the alternative tax should include that portion of such gains which is payable to an estate or trust's charitable beneficiary and which is vested in said charitable beneficiary even prior to its receipt by the estate or trust. That Congress may have considered and decided not to permit, for purposes of the alternative tax computation, a reduction of long-term capital gains by the excess of ordinary deductions over ordinary income does not at all speak to the question of which, and whose, long-term capital gains are to be included within the measure on which the alternative tax is computed.

cal analysis of the statutory language is inconsistent not only with judicial precedent;[5] it is inconsistent also with the respondent's own interpretation of the statute, which interpretation (prior to this case) has been manifested principally in two contexts. One was the respondent's litigation position in *Sidles*,[6] in which the respondent contended that where income in respect of a decedent consists solely of long-term capital gains and the estate utilizes the alternative tax, the deduction permitted by §691(c) should be available *only* as an offset against the capital gains to which the alternative tax is applied, rather than being available as a deduction from ordinary income.[7] The other has been the respondent's administrative treatment of long-term capital gains distributed by an estate or trust to its taxable beneficiaries.

Under the respondent's analysis of §1201(b), as set forth in its brief herein,[8] the language of the statute permits no reduction of the statutorily defined "excess" by *any* deduction that might be available as an offset against income. From this analysis, it logically must follow, in the case of an estate or

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[5]As discussed in Petitioners' Opening Brief, at pp. 24-27, it is now well established that the language of §1201(b) does permit such an offset against long-term capital gains, in the situation of an otherwise unused deduction (permitted by §691(c)) for the federal estate tax attributable to "income in respect of a decedent." See, *Read v. United States* (5th Cir. 1963), 320 F.2d 550, *Meissner v. United States* (Ct.Cl. 1966), 364 F.2d 409, and *Estate of Harry B. Sidles* (1976), 65 Tax Ct. 873.

[6]*Estate of Harry B. Sidles* (1976), 65 Tax Ct. 873.

[7]As discussed in Petitioners' Opening Brief, footnote 17 at p. 26, the Tax Court rejected the respondent's argument and held instead that the estate could utilize the §691(c) deduction in whatever manner was most advantageous to it.

[8]Respondent's Brief, pp. 17-25.

trust receiving long-term capital gains and distributing such gains to a taxable beneficiary, that the tax on the estate or trust's capital gains under §1201(b) must be computed on *all* of the gains received by that entity (or on all of the "excess"), unreduced by any gains which the estate or trust has distributed to its taxable beneficiary and for which it has been allowed a distributions deduction under §661(a). Contrary to that logical result, however, the respondent's own administrative interpretation of §1201(b) in fact does permit the amount of such distributions to reduce the amount of gains on which the estate or trust's alternative tax is computed.

The respondent's administrative interpretation of §1201(b) is contained in the pertinent income tax return forms which the respondent has prescribed, and in the respondent's instructions thereto. In the case of an estate or trust these forms consist of the U.S Fiduciary Income Tax Return (Form 1041) and of the Schedule D thereto, entitled Gains and Losses From Sales or Exchanges of Property. Copies of these forms, together with the appropriate instructions, for the year 1968 (the later of the two years at issue herein), are attached hereto as Exhibit A. In order to illustrate the inconsistency between the respondent's statutory analysis in this case and the respondent's administrative interpretation in the case of long-term capital gains passing to an estate or trust's taxable beneficiaries, these forms have been completed, in relevant part, pursuant to the respondent's instructions, based upon an assumed hypothetical situation in which an estate or trust's sole income, gross and net, is $100,000 in long-term capital gains, of which $40,000

is to be paid or set aside for charity and $60,000 is to be distributed to a taxable beneficiary. As can be seen from the "Computation of Alternative Tax" set forth on lines 17 through 22 of Schedule D, the resulting alternative tax is $10,000, which amount represents 25% of only the $40,000 of capital gains which was paid or set aside for charity, or, expressed somewhat differently, 25% of all the capital gains received by the estate or trust ($100,000) *reduced by* the amount of capital gains distributed to the estate or trust's taxable beneficiary ($60,000).[9]

The respondent's application of §1201(b) in the case of long-term capital gains distributed to an estate or trust's taxable beneficiaries is thus a blatant contradiction of the "uniform verbal formula" which the respondent purportedly perceives in the statutory language, both in its allowance of a supposedly prohibited offset (in the determination of the amount of capital gains to which the alternative tax is applied), and in its singling out of the capital gains passing to charity for the denial of that offset.[10] The respondent would presumably attempt to justify this non-uniform application of its "uniform verbal formula" on the ground that amounts distributable to taxable beneficiaries of an estate or trust are subject to the conduit principle and that the conduit principle must take precedence over the respondent's otherwise immutable reading of §1201(b). Amounts passing to charitable beneficiaries, on the other hand, are not, according to the respondent, subject to the conduit principle, and thus such amounts must fall victim to the respondent's purported "uniform verbal formula." As set forth in the following section, the respondent's denial of the conduit principle's applicability to amounts passing to charity is as fallacious as the respondent's analysis of the statutory language of §1201(b).

[9]Tracing the example through the forms and instructions, it can be seen that the alternative tax shown on line 22 of Schedule D is equal to 50% of the amount shown on line 18, which amount, in turn, is equal to 50% of the amount shown on line 13(e). That amount, $40,000, is arrived at by subtracting from the total long-term capital gain, shown on lines 13(a) and (c) as $100,000, that portion thereof which the form describes as "taxable to beneficiaries", in the amount of $60,000 (at line 13(d)). This amount, in turn, is derived from column 1 of line 11, which is the column headed "Beneficiaries", as distinguished from column 2, headed "Fiduciary."

As can be seen from that section of the instructions to Schedule D which is entitled "Allocation of capital gains and losses", the return form reflects a general rule that gains "allocable to the beneficiary or beneficiaries" are to be entered in column 1 of line 11, subject to the specific provision that "any capital gains paid, or permanently set aside for the purpose specified in section 642(c) should be entered in column 2." Since the amount deductible at line 13(d) is limited to that portion of the capital gains which the form treats as allocable to a beneficiary, the result is an alternative tax computed on an amount which excludes the capital gains allocable to a taxable beneficiary but which is required to include capital gains allocable to a charitable beneficiary.

[10]The arbitrary restriction upon the statutory language of §1201(b), which the respondent here seeks to apply in the case of capital gains passing to charity, is itself a "creative rewriting of the Internal Revenue Code" (*United States v. Foster Lumber Co.*, 429 U.S. 32, at 49 [Stevens, J., concurring]) such as to be more properly the object of respondent's censure than of its support. It might be noted in this regard that the respondent also errs in alleging that the petitioners' interpretation of §1201(b) would "cumulate the benefits of the alternative tax and the ordinary income deductions." (Respondent's Brief, pp. 11, 24.) As demonstrated in their Opening Brief (hypothetical example at pp. 32-35), the petitioners' interpretation of §1201(b) results in an alternative tax precisely equal to that which would result if the amounts passing to charity from the estate or trust had never been received by that entity. It is rather the respondent's statutory construction, through the multiple deduction in which it results in the computation of the partial tax under §1201(b)(1) (Petitioners' Opening Brief, pp. 29-36), which might more aptly be characterized as tending to "cumulate" deductions.

II.

The Conduit Principle Is Applicable to Amounts Which an Estate or Trust Pays or Sets Aside for Charity.

The respondent's analysis of the conduit principle in this case is premised both upon a misstatement of the petitioners' argument and upon a disregard of the respondent's own administrative interpretation.

A. The Respondent Has Failed to Address the Petitioners' Analysis of the Conduit Principle.

In their opening brief herein, petitioners set forth their analysis of the pertinent provisions of Subchapter J (§§641-692) of the Internal Revenue Code, as demonstrating the applicability of the conduit principle to amounts which an estate or trust pays or sets aside for charity.[11] Specifically, the petitioners referred to §642(c) as the embodiment of that applicability and as manifesting what petitioners termed a "charitable conduit," in contradistinction to the "taxable conduit," reflected in §§661 and 662.[12] The respondent, in its brief herein, does not attempt to refute this analysis, but simply misstates it, apparently so that the respondent can then attack a spurious analysis of its own imagination.

As stated by the respondent, "[t]he fundamental error in petitioners' position . . . is the assumption that capital gains set aside by an estate for charity are subject to the conduit rules of Sections 661 and 662."[13] But, as indicated above, the petitioners have never assumed, or even contended, that the conduit

[11]Petitioners' Opening Brief at pp. 14-18.

[12]Petitioners' Opening Brief, footnote 14 at p. 17.

[13]Respondent's Brief, p. 35.

rules reflected in §§661 and 662 were designed to cover amounts set aside for charity. To the contrary, petitioners have described the provisions of Subchapter J as providing for two distinct conduits, one being the charitable conduit, manifested in §642(c) for amounts paid or set aside for charity, and the other being the taxable conduit, reflected in §§661 and 662 for amounts distributed to an estate or trust's taxable beneficiaries. Accordingly, the respondent's assertion that amounts set aside for charity are excluded from the operation of §§661 and 662 is wholly consistent with the petitioners' analysis of the statutory provisions.

B. The Respondent Has Disregarded Its Own Administrative Interpretation of the Conduit Principle.

As the foregoing section indicates, the respondent's analysis of the conduit principle is premised upon a misstatement of petitioners' position respecting the operation of, and the relationship between, §642(c) and §§661 and 662. The respondent compounds the error of its analysis (both with respect to the operation of the statutory provisions and with respect to the petitioners' contentions in that regard) by wrongfully attributing to petitioners a contention that capital gains passing to charity are included within "the definition of distributable net income in §643(a)(3)"[14] and by then proceeding to misconstrue the operation of §643(a)(3) in supposed conformity to that alleged contention and in total disregard of respondent's own administrative interpretation of §643(a).

[14]Respondent's Brief, p. 37. Compare discussion in Petitioners' Opening Brief, footnote 14 at pp. 17-18. As noted therein, distributable net income functions as the measuring device for the amount of income which may pass through the taxable conduit under §§661 and 662.

According to the respondent, the computation of distributable net income under §643(a) operates to "add back" (to the amount of taxable income which is the starting point of the distributable net income computation) the amount of capital gains set aside for charity, with the result that distributable net income, as computed under §643(a), includes the amount of capital gains set aside for charity "in order to prevent a non-charitable beneficiary from deriving an advantage from the estate's charitable deduction."[15] As a demonstration of this purported statutory mechanism, and the imagined congressional policy which it is supposedly designed to implement, the respondent posits a hypothetical situation[16] in which an estate has received ordinary gross income of $60,000 and net long-term capital gains of $40,000, and, pursuant to the will, the entire $40,000 is to be distributed to charity. According to the respondent, the supposed "capital gains add-back" of §643(a) will result, in the hypothetical, in distributable net income of $100,000 (in spite of the fact that the estate's taxable income was $60,000), and that $100,000 rather than $60,000 will be the limit on which the estate's taxable beneficiaries can be taxed for amounts distributed to them.

While respondent's interpretation of §643(a), as set forth in its brief herein and specifically in the hypothetical example described above, might be consistent with respondent's analysis of the conduit principle for purposes of this lawsuit, that interpretation is inconsistent both with the statutory language and with the respondent's existing administrative interpretation, as contained

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[15]Respondent's Brief, p. 38.

[16]Respondent's Brief, footnote 18, at pp. 38-39.

in the return forms and instructions which the respondent itself has promulgated. Attached hereto as Exhibit B are copies of the U.S. Fiduciary Income Tax Return (Form 1041) and the related schedule entitled Gains and Losses From Sales or Exchanges of Property (Schedule D), for the year 1968, completed, in relevant part, on the basis of the figures contained in the respondent's hypothetical example referred to above and on the basis of the "1968 Instructions for Form 1041." (A copy of said Instructions is included as a part of Exhibit A hereto.) As these forms demonstrate, the application of the respondent's instructions to the respondent's hypothetical example results in distributable net income (as set forth in Schedule C of the Form 1041), not in the amount of $100,000 as the respondent contends, but rather in the amount of $60,000, *i.e.*, the amount of the estate's income exclusive of the capital gains set aside for charity.[17]

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[17]The computation of distributable net income, contained in Schedule C, begins on line 1 of that Schedule with $80,000, which is the amount of gross income ($100,000) less the amount of the charitable deduction ($20,000, or 50% of the $40,000 capital gain). To this $80,000 is added (by line 2c), the amount of the charitable deduction attributable to capital gains ($20,000), as computed at lines 4 and 7 of Schedule B. (Under the instructions to Schedule B, line 4 would contain 50% of capital gains allocable to income and line 7 would contain 50% of capital gains allocable to corpus. Thus, depending on one's assumption as to the allocability (under the pertinent local law) of the capital gains as between income and corpus, 50% thereof must appear either on line 4 or line 7 of Schedule B; for purposes of the example, the capital gain has been treated as allocable to corpus, and hence 50% thereof appears on line 7 of Schedule B.)

From the total of $100,000 ($80,000 plus $20,000) on line 3, there is deducted, by line 4 of Schedule C, the full amount of net capital gain ($40,000), resulting in distributable net income, at line 5, of $60,000.

A critical element in the computation prescribed by the forms and instructions, and one which highlights the difference

(This footnote is continued on next page)

As set forth in Petitioners' Opening Brief, distributable net income becomes the measuring instrument for the taxable conduit reflected in §§661 and 662, and it is therefore appropriate that amounts which have in effect passed through the charitable conduit of §642(c) should not be included in distributable net income. The respondent's hypothetical example, through the application of the respondent's own published instructions (as distinguished from the respondent's conclusory analysis of that hypothetical as contained in its brief herein), demonstrates that §643(a) does, in fact, accomplish the exclusion of capital gains set aside for charity from distributable net income and thereby reflects the integrity and distinctness of the two conduits, charitable and taxable, which are manifested in Subchapter J.

In its effort to substantiate its distorted version of the conduit principle, the respondent also makes reference to "the special computational rule of Section 662 (a)(1)".[18] This section provides that a beneficiary receiving income "required to be distributed currently" may be required to include such receipts in his taxable income to the extent of his share of distributable net

between capital gains which are allocable to charities and those which are allocable to non-charitable beneficiaries, is the provision at line 2b of Schedule C for the addition to taxable income of the "[n]et gain shown on line 12, column 1, Schedule D, Form 1041." Since the instructions to Schedule D provide for the entry in "column 2", rather than in "column 1", of "any capital gains paid, or permanently set aside for the purpose specified in §642(c)", capital gains which are paid or set aside for a charitable beneficiary are omitted at this stage of the distributable net income computation and are thereby effectively excluded from the amount of distributable net income, as derived at line 5 of Schedule C.

[18]Respondent's Brief, p. 41.

income, as computed *without* regard to the charitable deduction allowed under §642(c). Section 662(a)(1) thus operates, within its limited scope, as the "add-back" provision which the respondent has mistakenly perceived in §643(a). However, the "add-back" of §662(a)(1) is not, as the respondent contends, inconsistent with the operation of §642(c) as a charitable conduit or with the operation of §643(a) as reflecting the distinction between the charitable and taxable conduits. To the contrary, the very fact that §662(a)(1) contains such an "add-back" provision is compelling proof that, as defined by §643(a) (and except as modified by application of the special statutory provision contained in §662(a)(1)), distributable net income does not include those amounts which pass to a charitable beneficiary and are deductible by the estate or trust under §642(c).[19]

[19]The "add-back" provision of §662(a)(1) is entirely consistent with, and in fact reflective of, the reality and distinctness of the two conduits manifested in Subchapter J. Except in the situation covered by that subsection's limited scope, the general rule still prevails: amounts deductible under §642(c) are treated as passing through the charitable conduit and hence are not includable within distributable net income, which defines the amount available for passage through the taxable conduit and potentially taxable to the estate or trust's taxable beneficiaries. Thus, those taxable beneficiaries who receive amounts described in §662(a)(2) (*i.e.*, anything other than "income required to be distributed currently") are limited, as to their taxability for such amounts, to distributable net income which does not include amounts passing through the charitable conduit under §642(c). The effect of §662(a)(1) is simply to provide that, in the case of a beneficiary receiving "income required to be distributed currently", the priority of the conduits is to be reversed and that, as far as *that* taxable beneficiary is concerned, the income of the estate or trust is treated as passing first through his conduit, before application of the charitable conduit of §642(c). Such express provision for an exception to the general rule, in the case of the §662(a)(1) beneficiary, serves to highlight the reality and general priority of the charitable conduit.

The respondent's misconstruction in this case of the operation of §643(a), in complete disregard of its own administrative construction, illustrates the faulty reasoning upon which the respondent's analysis of the conduit principle is based. Both by such misconstruction and by misperceiving the petitioners' analysis of the conduit principle, the respondent has avoided facing, and has left unanswered, the manifestation of that principle in §642(c).

Conclusion.

The application of the alternative tax for which the respondent contends in this case is premised, first, upon a mechanical reading of §1201(b), so as to preclude any reduction of the amount of the long-term capital gains "excess" which is subject to the 25% tax under §1201(b)(2), and second, upon a distorted reading of Subchapter J, so as to deny the applicability of the conduit principle to amounts passing to charitable beneficiaries of estates and trusts. These statutory interpretations by the respondent are violative both of established judicial construction and of the respondent's own administrative construction of the statutory language. As set forth herein and in Petitioners' Opening Brief, the language of §1201(b) *does* permit the amount of capital gains subject to the 25% tax under §1201(b)(2) to be reduced by long-term capital gains passing to charity, and the conduit principle manifested in Subchapter J of the Internal Revenue Code, and specifically in §642(c),

does apply to the charitable beneficiaries of estates and trusts.

For all of the reasons stated herein and in their Opening Brief, the petitioners respectfully request that the decision by the Ninth Circuit Court of Appeals herein be reversed.

GIBSON, DUNN & CRUTCHER,
RONALD E. GOTHER,
MARC R. ISAACSON,
Attorneys for Petitioners.

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FORM **1041**
U.S. Treasury Department
Internal Revenue Service

U.S. Fiduciary Income Tax Return

for the year January 1–December 31, 1968, or other taxable year
beginning _____, 1968, ending _____, 19__

1968

PLEASE PRINT OR TYPE

Check whether:
- ☐ Estate
- ☐ Simple trust
- ☐ Complex trust

If trust, check whether:
- ☐ Testamentary
- ☐ Inter vivos

Name of estate or trust | Employer Identification Number

Name and title of fiduciary

Address of fiduciary (number and street)

City, State, and ZIP code

Simple trusts are not required to fill in Schedules B and C.

INCOME	1 Dividends (Enter full amount before exclusion)		
	2 Interest		
	3 Income from partnerships and other fiduciaries		
	4 Gross rents and royalties		
	5 Gross profit (loss) from trade or business		
	6 Net gain (loss) from capital assets (line 12, column 3, Schedule D, Form 1041)	100,000	
	7 Net gain (loss) from property other than capital assets (line 24, Schedule D, Form 1041)		
	8 Other income (State nature of income)		
	9 Total income (lines 1 to 8, inclusive)		100,000
DEDUCTIONS	10 Interest		
	11 Taxes		
	12 Fiduciary's portion of depreciation (Schedule A) and depletion. Explain depletion		
	13 Charitable deduction (line 9, Schedule B)	20,000	
	14 Other deductions (itemize)		
	15 Total (lines 10 to 14, inclusive)		20,000
	16 Line 9 minus line 15 (Complex trusts and estates enter this amount on line 1 in Schedule C also)		80,000
	17 Deduction for distributions to beneficiaries	60,000	
	18 Adjustment of dividend exclusion		
	19 Federal estate tax attributable to income in respect of a decedent (Fiduciary's share)		
	20 Long-term capital gain deduction. Enter 50% of line 13(e), Schedule D, Form 1041	20,000	
	21 Exemption		
	22 Total (lines 17 to 21, inclusive)		80,000
	23 Taxable income of fiduciary (line 16 minus line 22)		0
COMPUTATION OF TAX	24 Tax on amount on line 23 (See tax rate schedule)		
	25 If alternative tax is applicable, enter the tax from line 22, Schedule D, Form 1041		
	26 Tax surcharge (See instruction 26)		
	27 Total (line 24 or line 25, whichever is applicable, and line 26)		
	28 Fiduciary's share of foreign tax credit (Attach Form 1116)		
	29 Fiduciary's share of investment credit (Attach Form 3468)		
	30 Total (lines 28 and 29)		
	31 Balance (line 27 less line 30)		
	32 Tax from recomputing fiduciary's share of prior year investment credit (Attach statement)		
	33 Total (lines 31 and 32)		
	34 Fiduciary's share of credit for tax paid at source on tax-free covenant bond interest		
	35 Credit for nonhighway Federal gasoline tax and lubricating oil (Attach Form 4136)		
	36 Credit for regulated investment companies (Attach Form 2439)		
	37 Tax previously paid or withheld (Attach explanation)		
	38 Total (lines 34 to 37, inclusive)		
	39 Balance of tax due (line 33 less line 38)		
	40 Overpayment (line 38 less line 33)		

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief it is true, correct, and complete. If prepared by a person other than taxpayer, his declaration is based on all information of which he has any knowledge.

Sign here ▶ _____ Signature of fiduciary or officer representing fiduciary — Date

▶ _____ Signature of preparer other than fiduciary — Address — Date

☆☆☆☆ U.S. GOVERNMENT PRINTING OFFICE : 1968—O-290-018

EXHIBIT A

Schedule A.—DEPRECIATION— Taxpayers using Revenue Procedures 62-21 and 65-13: Make no entry in column 2, enter the cost or other basis of assets held at end of year in column 3, and enter the accumulated depreciation at end of year in column 4.

1. Group and guideline class or description of property	2. Date acquired	3. Cost or other basis	4. Depreciation allowed or allowable in prior years	5. Method of computing depreciation	6. Life or rate	7. Depreciation for this year
1 Total additional first-year depreciation—estates only (do not include in items below) →						
2 Totals						
3 Less amount of depreciation claimed elsewhere on return						
4 Balance (line 2 less line 3)						
5 Fiduciary's portion of line 4. Enter here and on line 12, page 1						

Schedule B.—CHARITABLE DEDUCTION— (Attach statement giving name and address of charitable organization.)

1 Amounts paid or permanently set aside for charitable purposes from current year's income			40,000
2 Tax-exempt interest allocable to charitable distribution			
(Complete lines 3 and 4 below only if gain on line 11, column 2, Schedule D, Form 1041, exceeds loss on line 10, column 2, Schedule D, Form 1041)			
3 (a) Long-term capital gain included on line 1 (Do not complete lines (b) and (c) if such amounts are greater than line (a))	40,000		
(b) Enter gain on line 11, column 2, Schedule D, Form 1041, minus loss on line 10, column 2, Schedule D, Form 1041	40,000		
(c) Enter gain on line 11, column 3, Schedule D, Form 1041, minus loss on line 10, column 3, Schedule D, Form 1041	100,000	20,000	
4 Enter 50% of the smallest of line 3(a), line 3(b), or line 3(c)			20,000
5 Enter sum of line 2 and line 4			20,000
6 Balance (line 1 minus line 5)			
7 Enter short-term capital gains and 50% of the long-term capital gains of the current taxable year allocable to corpus, paid or permanently set aside for charitable purposes			
8 Amounts paid or permanently set aside for charitable purposes other than from income of the current year			
9 Total (line 6 plus lines 7 and 8). Enter here and on line 13, page 1			20,000

Schedule C.—DISTRIBUTABLE NET INCOME AND DISTRIBUTIONS DEDUCTION

1 Enter amount from line 16, page 1	80,000
2 Add: (a) Tax-exempt interest (as adjusted)	
(b) Net gain shown on line 12, column 1, Schedule D, Form 1041. If net loss, enter zero	60,000
(c) Lines 4 and 7, Schedule B	20,000
(d) Short-term capital gain included on line 1, Schedule B	
(e) If amount on line 6, page 1, is a loss, enter amount here	
3 Total (line 1 through line 2(e))	160,000
4 If amount on line 6, page 1, is a gain, enter amount here	100,000
5 Distributable net income (line 3 minus line 4)	60,000
6 Amount of income required to be distributed currently	60,000
7 Other amounts paid, credited, or otherwise required to be distributed	
8 Total (lines 6 and 7)	60,000
9 Enter the total of tax-exempt income included on lines 6 and 7	
10 Balance (line 8 minus line 9)	60,000
11 Enter distributable net income (line 5, above)	60,000
12 Enter the amount from line 2(a), above	
13 Balance (line 11 minus line 12)	60,000
14 Distributions deduction. Enter here and on line 17, page 1, the lesser of line 10 or line 13 above	60,000

1 Date trust was created or, if an estate, date of decedent's death. _____

2 If return is for an estate, has a United States Estate Tax Return been filed? ☐ Yes ☐ No. If "No," will return be filed? ☐ Yes ☐ No ☐ Uncertain.

3 If you had tax-exempt income, have you deducted only that portion of expenses allocable to taxable income? ☐ Yes ☐ No.

4 Has final distribution of assets been made during the year? ☐ Yes ☐ No.

5 If the estate or trust received income from a nominee, state name, employer identification number, and address of nominee.

_____

_____

_____

16—68231-1

☆☆☆☆ U.S. GOVERNMENT PRINTING OFFICE : 1968—O-290-018

SCHEDULE D (Form 1041)
U.S. Treasury Department
Internal Revenue Service

Gains and Losses From Sales or Exchanges of Property

1968

Name of estate or trust

Part I—CAPITAL ASSETS—Short-Term Capital Gains and Losses—Assets Held Not More Than 6 Months

a. Kind of property (if necessary, attach statement of descriptive details not shown below)	b. Date acquired (mo., day, yr.)	c. Date sold (mo., day, yr.)	d. Gross sales price	e. Depreciation allowed (or allowable) since acquisition	f. Cost or other basis, cost of subsequent improvements (if not purchased, attach explanation) and expense of sale	g. Gain or loss (d plus e less f)
1						

2 Enter your share of net short-term gain (or loss) from partnerships and other fiduciaries . . . . .
3 Enter unused short-term capital loss carryover from preceding taxable years (attach statement) . . . . .
4 Net short-term gain (or loss) from lines 1, 2, and 3. Enter here and on line 10 below . . . . .

Long-Term Capital Gains and Losses—Assets Held More Than 6 Months

5						100,000

6 Enter the full amount of your share of net long-term gain (or loss) from partnerships, other fiduciaries, etc. . . . .
7 Enter unused long-term capital loss carryover from preceding taxable years (attach statement) . . . . .
8 Capital gain dividends . . . . .
9 Net long-term gain (or loss) from lines 5, 6, 7, and 8. Enter here and on line 11 below 100,000

CAPITAL GAINS AND LOSSES

	1. Beneficiaries	2. Fiduciary	3. Total
10 Net short-term gain or loss from line 4, above			
11 Net long-term gain or loss from line 9, above	60,000	40,000	100,000
12 Total net gain or loss	60,000	40,000	100,000

Enter on line 6, page 1, Form 1041, the net gain shown on line 12, column 3, above. If net loss on line 12, column 3, above, enter as loss on line 6, page 1, Form 1041, whichever of the following is the smallest amount: (i) the amount of the loss, (ii) taxable income computed without regard to capital gains and losses and the deduction for exemption, or (iii) $1,000.

COMPUTATION OF FIDUCIARY'S CAPITAL GAINS DEDUCTION

13(a) Long-term capital gain shown on line 11, column 3, above	100,000
(b) Short-term capital loss shown on line 10, column 3, above	
(c) Excess of line 13(a) over line 13(b), above	100,000
(d) Long-term capital gains taxable to beneficiaries	60,000
(e) Balance (line 13(c) minus line 13(d)). (Enter 50% of this amount on line 20, page 1, Form 1041.) . . .	40,000

Part II—GAIN FROM DISPOSITION OF DEPRECIABLE PROPERTY UNDER SECTIONS 1245 AND 1250—Assets Held More Than 6 Months—Where double headings appear, use the first heading for section 1245 and the second heading for section 1250.

a. Kind of property (if necessary, attach statement of descriptive details not shown below—write 1245 or 1250 to indicate type of asset)	b. Date acquired (mo., day, yr.)	c. Date sold (mo., day, yr.)	d. Gross sales price	e. Cost or other basis, cost of subsequent improvements (if not purchased, attach explanation) and expense of sale
14				

f. Depreciation allowed (or allowable) since acquisition		g. Adjusted basis (e less sum of f-1 and f-2)	h. Total gain (d less g)	i. Ordinary gain (lesser of f-2 or h) — OR — (see instructions)	j. Other gain (h less i)
f-1. Prior to January 1, 1962 — OR — Prior to January 1, 1964	f-2. After December 31, 1961 — OR — After December 31, 1963				

15 Total ordinary gain. Enter here and in column g, line 23, Part III . . . . .
16 Total other gain. Enter here and in column g, line 5, Part I; however, if the gains do not exceed the losses when this amount is combined with other gains and losses from section 1231 property, enter the total of column j in column g, line 23, Part III . . . . .

16—60113-1

COMPUTATION OF ALTERNATIVE TAX

If fiduciary had a net long-term capital gain or an excess of net long-term capital gain over net short-term capital loss shown in column 2, line 12, and line 23, page 1, Form 1041, exceeds $26,000, it may be to his advantage to make the alternative tax computation.

17 Amount from line 23, page 1, Form 1041	~~0~~
18 50% of amount on line 13(e)	20,000
19 Balance (line 17 minus line 18)	~~0~~
20 Tax on amount on line 19 (see tax rate schedule)	~~0~~
21 50% of amount on line 18, above	10,000
22 Alternative tax (line 20 plus line 21); if less than line 24, page 1, Form 1041, enter this amount on line 25, page 1, Form 1041	10,000

Part III—PROPERTY OTHER THAN CAPITAL ASSETS

a. Kind of property (if necessary, attach statement of descriptive details not shown below)	b. Date acquired (mo., day, yr.)	c. Date sold (mo., day, yr.)	d. Gross sales price	e. Depreciation allowed (or allowable) since acquisition	f. Cost or other basis, cost of subsequent improvements (if not purchased, attach explanation) and expense of sale	g. Gain or loss (d plus e less f)
23						

24 Net gain (or loss). Enter here and on line 7, page 1, Form 1041 . . . . .

INSTRUCTIONS
(References are to the Internal Revenue Code)

Gains and losses from sales and exchanges of capital assets and other property.—In computing gross income no distinction is made between gains and losses allocable to income account and those allocable to corpus account.

"Capital assets" defined.—The term "capital assets" means property held by the estate or trust (whether or not connected with the trade or business) but does NOT include—

(*a*) stock in trade or other property of a kind properly includible in inventory if on hand at the close of the taxable year;

(*b*) property held by the taxpayer primarily for sale to customers in the ordinary course of trade or business;

(*c*) property used in the trade or business of a character which is subject to the allowance for depreciation provided in section 167;

(*d*) real property used in the trade or business of the taxpayer;

(*e*) certain government obligations issued on or after March 1, 1941, at a discount, payable without interest and maturing at a fixed date not exceeding one year from date of issue;

(*f*) certain copyrights, literary, musical, or artistic compositions, etc.; or

(*g*) accounts and notes receivable acquired in the ordinary course of trade or business for services rendered or from the sale of property referred to in (*a*) or (*b*) above.

Gains and losses from transactions described in section 1231 (see below) shall be treated as gains and losses from the sale or exchange of capital assets held for more than 6 months if the total of these gains exceeds the total of these losses. If the total of these gains does not exceed the total of these losses, such gains and losses shall not be treated as gains and losses from the sale or exchange of capital assets. Thus, in the event of a net gain, all these transactions should be entered in the "long-term capital gains and losses" portion of Schedule D. In the event of a net loss, all these transactions should be entered in the "property other than capital assets" portion of Schedule D, or in other applicable schedules on Form 1041.

Section 1231 deals with gains and losses arising from—

(*a*) sale, exchange, or involuntary conversion, of land (including in certain cases unharvested crops sold with the land) and depreciable property if they are used in the trade or business and held for more than 6 months,

(*b*) sale, exchange, or involuntary conversion of livestock (but not including poultry) held for draft, breeding, or dairy purposes and held for 1 year or more,

(*c*) the cutting of timber or the disposal of timber, coal, or domestic iron ore to which section 631 applies, and

(*d*) the involuntary conversion of capital assets held more than 6 months.

See sections 1231 and 631 for specific conditions applicable.

Gain from disposition of depreciable property under sections 1245 and 1250—Assets held more than 6 months (Part II).—(Report any gain from such property held for 6 months or less in Part III.) Except as provided below, section 1245 property means depreciable (*a*) personal property (other than livestock) including intangible personal property; and (*b*) tangible real property (except for buildings and their structural components) if used as an integral part of manufacturing, production, or extraction, or of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services, or used as a research or storage facility in connection with these activities; and (*c*) elevators and escalators.

Except as provided below, section 1250 property means depreciable real property (other than section 1245 property).

See sections 1245 (b) and 1250 (d) for exceptions and limitations involving: (*a*) disposition by gift; (*b*) transfers at death; (*c*) certain tax-free transactions; (*d*) like kind exchanges, involuntary conversions; (*e*) sales or exchanges to effectuate FCC policies and exchanges to comply with S.E.C. orders; (*f*) property distributed by a partnership to a partner; and (*g*) disposition of principal residence (section 1250 only).

Column f of Part II.—In computing depreciation allowed or allowable for elevators or escalators, enter in column f-1 depreciation prior to July 1, 1963, and in column f-2 depreciation after June 30, 1963.

Column i of Part II, section 1250 property only.—If held for more than 6 months, but not more than 1 year, enter the smaller of (1) column h, or (2) column f-2. If held for more than 1 year, enter the result of multiplying the smaller of (1) column h, or (2) column f-2 less the amount of depreciation computed for the same period using the straight line method, by the percentage obtained by subtracting from 100%, one percentage point for each full month the property was held in excess of 20 months. Where substantial improvements have been made within the preceding 10 years, see section 1250 (*f*).

(Instructions continued on reverse of duplicate)

18—60113-1

☆☆☆☆ U.S. GOVERNMENT PRINTING OFFICE : 1969—O-290-108

COMPUTATION OF ALTERNATIVE TAX

If fiduciary had a net long-term capital gain or an excess of net long-term capital gain over net short-term capital loss shown in column 2, line 12, and line 23, page 1, Form 1041, exceeds $26,000, it may be to his advantage to make the alternative tax computation.

17 Amount from line 23, page 1, Form 1041	
18 50% of amount on line 13(e)	
19 Balance (line 17 minus line 18)	
20 Tax on amount on line 19 (see tax rate schedule)	
21 50% of amount on line 18, above	
22 Alternative tax (line 20 plus line 21); if less than line 24, page 1, Form 1041, enter this amount on line 25, page 1, Form 1041	

Part III—PROPERTY OTHER THAN CAPITAL ASSETS

a. Kind of property (if necessary, attach statement of descriptive details not shown below)	b. Date acquired (mo., day, yr.)	c. Date sold (mo., day, yr.)	d. Gross sales price	e. Depreciation allowed (or allowable) since acquisition	f. Cost or other basis, cost of subsequent improvements (if not purchased, attach explanation) and expense of sale	g. Gain or loss (d plus e less f)
23						
24 Net gain (or loss). Enter here and on line 7, page 1, Form 1041						

INSTRUCTIONS—(Continued from reverse side of the original)

Basis.—In determining gain or loss for property acquired after February 28, 1913, use cost, except where property was acquired by bequest, gift, tax-free exchange, involuntary conversion, or wash sale of stock. See sections 1014, 1015, 1031, 1033, and 1091, respectively. If the amount shown as the basis is other than actual cash cost of the property sold or exchanged, full details must be furnished regarding the acquisition of the property.

Limitation on allowable capital losses.—If the sum of all the capital losses exceeds the sum of all the capital gains (all such gains and losses to be taken into account at 100 percent), then such capital losses shall be allowed as a deduction only to the extent of (1) current year capital gains plus (2) the smaller of either the taxable income of the current year or $1,000. For this purpose taxable income is computed without regard to capital gains or losses or the deduction for exemption. The excess of such allowable losses over the sum of items (1) and (2) above is called "capital loss carryover." Any such carryover loss may be carried forward indefinitely. Capital losses retain their character as either short-term or long-term when carried over to the succeeding year. To the extent the net capital losses are deducted from ordinary income, the net short-term capital loss must be considered as deducted first.

Losses in transactions between certain persons.—No deduction is allowable for losses from sales or exchanges of property directly or indirectly between (*a*) members of a family, (*b*) a corporation and an individual (or a fiduciary) owning more than 50 percent of the corporation's stock (liquidations excepted), (*c*) a grantor and fiduciary of any trust, (*d*) a fiduciary and a beneficiary of the same trust, (*e*) a fiduciary and a fiduciary or beneficiary of another trust created by the same grantor; or (*f*) an individual and a tax-exempt orgnization controlled by the individual or his family.

Redemption of stock to pay death taxes.—Section 303 deals with redemption of stock (to pay death taxes and certain expenses) included in an estate. List and identify such stock in the appropriate section and state the name of the decedent and the District Director's office in which the estate tax return was filed.

Allocation of capital gains and losses.—On line 10, enter in column 1 the amount of short-term gain or loss allocable to the beneficiary or beneficiaries. This includes (*a*) any amount (whether or not paid, credited, or required to be distributed to beneficiaries) which is a short-term capital gain under the Internal Revenue Code but which is an item of trust income under the terms of the governing instrument and local law, and (*b*) any amount which is a short-term capital gain under the Internal Revenue Code and which is allocable to corpus under the terms of the governing instrument and local law, but which is, nevertheless, paid, credited, or required to be distributed to any beneficiary. However, any capital gains paid, or permanently set aside for the purpose specified in section 642 (c) should be entered in column 2.

Include on line 10, column 1, only those short-term capital losses which are taken into account in determining the amount of gain from the sale or exchange of capital assets which is paid, credited, or required to be distributed to any beneficiary during the taxable year. Enter in column 2 the amount of the short-term gain or loss allocable to the fiduciary. The amount in column 3 should be the same as the amount shown on line 4.

The long-term gain or loss is treated on line 11 just as short-term gain or loss is treated on line 10.

Fiduciary's capital gains deduction.—Section 1202 provides a special rule for the deduction for long-term capital gains of an estate or trust. The deduction is computed by excluding that portion of the gains from sales or exchanges of capital assets which is includible in the income of the beneficiaries. Lines 13 (*a*) through 13 (*e*) provide for the computation of long-term capital gains allocable to the fiduciary for the purpose of computing this deduction.

Capital gains dividends and undistributed capital gains of regulated investment companies.—Report in Schedule D, as long-term capital gains, any amount which a regulated investment company advises you is (a) a capital gain dividend, or (b) your share of the company's undistributed capital gains. Credit should be claimed on line 36, page 1, Form 1041, for 25 percent of (b), since such amount represents the tax imposed on a regulated investment company's undistributed capital gains which is deemed paid by the shareholders. Copy B of Form 2439 should be attached to page 1 of the fiduciary return to substantiate the credit. See section 852 and the regulations thereunder.

If the fiduciary makes a distribution to beneficiaries with respect to an "undistributed capital gain" it shall be treated by the fiduciary, and included in income of the beneficiaries, in the same manner as if the distribution to the beneficiaries resulted from a cash distribution by the regulated investment company.

16—90519-1

☆☆☆☆ U.S. GOVERNMENT PRINTING OFFICE : 1968—O-290-108

1968 Instructions for Form 1041

1968 U.S. Fiduciary Income Tax Return

(References are to the Internal Revenue Code, unless otherwise noted)

General instructions

A. Requirement of return.—Fiduciaries are required to file Form 1041 for:

(1) domestic estates with (a) gross income for the taxable year of $600 or over, or (b) any beneficiary who is a nonresident alien; and

(2) domestic trusts with (a) any taxable income for the taxable year, or (b) gross income of $600 or over regardless of the amount of taxable income, or (c) any beneficiary who is a nonresident alien.

B. Employer identification number.—Application for the employer identification number for the estate or trust must be made on Form SS–4, Application for Employer Identification Number. Form SS–4 may be obtained from any District Director of Internal Revenue or any district office of the Social Security Administration. Form SS–4 must be filed with the District Director of Internal Revenue for the district in which the fiduciary resides or has his principal place of business in sufficient time for the number to be issued before the Form 1041 is filed.

C. Other returns required of fiduciaries.—(1) *Forms 1040 and 1040–A.*—For last taxable year of decedent if gross income to date of death was $600 or more ($1,200, if age 65 or over). A fiduciary for a minor or an insane person must also file a return.

(2) *Form 1040NR.*—Nonresident alien beneficiaries, estates and trusts.

(3) *Form 1042.*—Income tax withheld at source on payments to nonresident aliens.

(4) *Forms 1096 and 1099.*—Certain payments of $600 or more made by estate or trust engaged in a trade or business.

D. Period to be covered by return.—Returns must be filed for the calendar year 1968 or fiscal year beginning in 1968. If return is filed for other than a calendar year, fill in the taxable year space at top of return. If this is the last return the taxpayer is required to file, write "FINAL RETURN" at the top of the form.

E. Time and place for filing return.—Returns must be filed, on or before the 15th day of the 4th month following the close of the taxable year of the estate or trust, with the District Director of Internal Revenue for the district in which the fiduciary resides or has his principal place of business **EXCEPT AS PROVIDED BELOW.** If the exception applies, the return must be filed with the Internal Revenue Service Center specified.

FIDUCIARIES IN SOUTHEAST REGION FILING IN 1969 OR LATER—

Alabama, Florida, Georgia, Mississippi, North Carolina, South Carolina, Tennessee	Internal Revenue Service Center 4800 Buford Highway Chamblee, Ga. 30006

FIDUCIARIES IN THE FOLLOWING REGIONS FILING IN 1970 OR LATER—

MID-ATLANTIC REGION

Delaware, District of Columbia, Maryland, New Jersey, Pennsylvania, Virginia	Internal Revenue Service Center 11601 Roosevelt Boulevard Philadelphia, Pa. 19155

CENTRAL REGION

Indiana, Kentucky, Michigan, Ohio, West Virginia	Internal Revenue Service Center Cincinnati, Ohio 45298

SOUTHWEST REGION

Arkansas, Colorado, Kansas, Louisiana, New Mexico, Oklahoma, Texas, Wyoming	Internal Revenue Service Center 3651 Interregional Highway Austin, Tex. 78740

WESTERN REGION

Alaska, Arizona, California, Hawaii, Idaho, Montana, Nevada, Oregon, Utah, Washington	Internal Revenue Service Center 1160 West 1200 South St. Ogden, Utah 84405

F. Signature and verification.—The return must be signed by the individual fiduciary, or by the authorized officer of the organization receiving or having custody or control and management of the income of the estate or trust.

The return must also be signed by the person, or in the name of the firm or corporation preparing the fiduciary's return for compensation. This verification is not required if the return is prepared by a regular full-time employee of the fiduciary.

G. Payment of tax.—The tax of a trust must be paid in full when the return is filed. The tax of an estate must be paid in full when the return is filed or in four equal installments on or before the 15th day of the 4th, 7th, 10th, and 13th months following the close of the taxable year.

The tax may be paid in cash or by check or money order drawn to the order of "Internal Revenue Service." Please enter the employer identification number on all remittances.

H. Copy of governing instrument and fiduciary's declaration.—If the gross income of the estate or trust is $5,000 or over, a copy of the will or trust instrument accompanied by the written declaration of the fiduciary under the penalties of perjury that it is a true and complete copy must be filed with the return of the estate or trust.

The fiduciary must also file with the return his statement indicating the provisions of the governing instrument which in his opinion determine the extent to which the income of the estate or trust is taxable to the estate or trust, to the beneficiaries, or to the grantor or a person other than the grantor. In making such determination, the fiduciary must give particular attention to sections 671 through 678 which relate (*a*) to taxation of the income of a trust to the grantor because of his retention or possession of (i) a reversionary interest, (ii) a power to revoke or to control beneficial enjoyment, (iii) administrative powers, or (iv) the right to income, and (*b*) to taxation of the income of a trust to a person other than the

US Treasury Department **Internal Revenue Service**

grantor because of the possession of such power over the trust as would constitute such a person the substantial owner of all or a portion of the trust.

If a copy of the governing instrument and the statement of the fiduciary have once been filed with a return, they need not again be filed, provided subsequent returns contain a statement showing when and where such documents were filed. However, if the instrument is amended in any way after a copy has been filed, a copy of the amendment must be filed with the return for the taxable year in which the amendment is made. The fiduciary must also file his statement indicating the effect, if any, in his opinion, of such amendment on the extent to which the income of the trust is taxable to the trust, the beneficiaries, or to the grantor or a person other than the grantor.

I. Accounting period. — To change your accounting period, see section 1.442–1 of the regulations and Form 1128, Application for Change in Accounting Period.

J. Accounting methods. — Taxable income must be computed using the method of accounting regularly used by the taxpayer in maintaining its books and records. In all cases the method adopted must clearly reflect taxable income. (See section 446.) Unless the law specifically permits, a taxpayer may not change the method of accounting used to report income in prior years (for income as a whole or for any material item) without first securing consent on Form 3115, Application for Change in Accounting Method.

Rounding off to whole-dollar amounts. The money items on your return and accompanying schedules may be shown as whole-dollar amounts by eliminating any amount less than 50 cents and increasing any amount from 50 cents through 99 cents to the next higher dollar.

K. Income of decedents and deduction for Federal estate tax.—Section 691 provides for the inclusion, when received, in gross income of an estate or trust of amounts of gross income which, although attributable to the decedent, were not properly includible in his return for any period up to the date of his death. This includes income from installment obligations. The same section allows deductions for business expenses, interest, taxes, depletion, etc., and foreign tax credits to the estate or other person receiving the property to which the deduction or credit pertains.

Federal estate tax previously paid, which was attributable to the inclusion in a decedent's gross estate of the right to receive items of income treated as income in respect of a decedent and includible in gross income on the fiduciary return, is allowable as a deduction either to the fiduciary or to the beneficiaries, depending on whether or not such income is paid, credited, or required to be distributed. The fiduciary is entitled to deduct only the portion of the estate tax attributable to such income, which was not (during the taxable year in which received) paid, credited, or required to be distributed to a beneficiary. See the regulations under section 691 for further information on the computation of the deduction. The amount allowable to the fiduciary should be deducted on line 19, page 1 of the return. Any deductions in this connection to which beneficiaries are entitled must be shown on line 7 of Schedule E (Form 1041), or the fiduciary's acceptable substitute.

L. Final return.—If final distribution of assets has been made during the year, all income of the estate or trust must be entered as distributed to the beneficiaries and no deduction is allowable for exemption.

M. Unused loss carryover and excess deductions on termination.—On final termination of an estate or trust there are certain types of deductions which may be passed on to beneficiaries. If a net operating loss carryover under section 172, or a capital loss carryover under section 1212, would be allowable in a subsequent year if the estate or trust had not terminated, such carryover is allowable to the beneficiares succeeding to the property of the estate or trust. If for its final taxable year, the estate or trust is entitled to deductions (other than deductions for exemption and charitable deduction) in excess of its gross income, the excess deductions are allowable to such beneficiaries. See the regulations under section 642 for the methods of computing these deductions. If beneficiaries of an estate or trust are entitled to any of these deductions, the fiduciary must attach to the return a schedule showing the computation of each type of deduction and the allocation to beneficiaries. The type of deduction and the amount allocable to each beneficiary must also be shown on line 7 of Schedule E (Form 1041), or the fiduciary's acceptable substitute.

N. Income taxable to the grantor or substantial owner.—If any part of the income of the trust is taxable to the grantor under any of sections 673 through 677, or is taxable to another person under section 678, such part must not be reported on Form 1041; rather, such income and the deductions and credits applicable thereto must be shown in a separate statement to be attached to Form 1041.

O. Simple and complex trusts.—If the terms of the governing instrument of a trust require that all of its income (determined under the governing instrument and local law) be distributed currently and do not provide that any amounts may be paid, permanently set aside, or used in the taxable year for the charitable purposes specified in section 642(c), such a trust may quallify as a "simple" trust under section 651(a). Such a trust is qualified under section 651(a) only in those taxable years of the trust in which it does not distribute to a beneficiary amounts other than amounts of income (determined under the governing instrument and local law) required to be distributed currently. Section 651(a) is not applicable to estates.

Any trust which does not qualify for the taxable year under section 651(a) is treated as a "complex" trust under section 661(a). All estates are treated under section 661(a) in the same manner as "complex" trusts.

P. Completion of return.—The specific instructions explain how all estates and trusts should complete the lines on the form. However, since Schedules B and C of the return are necessary only for estates and complex trusts, the instructions relating to those schedules may be disregarded by simple trusts. Generally the same is also true as to Schedule D (Form 1041) in the case of simple trusts reporting no gains and losses from sales and exchanges of capital assets and other property. Schedule E (Form 1041), or the fiduciary's acceptable substitute, must be filed with Form 1041 for each beneficiary.

Q. Certain dividends received by simple trusts.—An exception to the instructions applies in the case of a simple trust receiving extraordinary dividends or taxable stock dividends, or both, which the trustee, acting in good faith, does not pay or credit to any beneficiary because of his determination that they are allocable to corpus under the terms of the governing instrument and local law. The law provides that such items must be excluded from distributable net income. If line 1, page 1 of the return includes any dividends so treated, they must be excluded from the amount on line 17 and from Schedule E (Form 1041), or the fiduciary's acceptable substitute, and an explanatory statement must be attached to the return.

R. Short-form method for simple trusts.—The following short-form method of completing the return may be used for simple trusts.

Simple trust without capital gains (or losses)

(a) *Reporting income and deductions.*—Complete lines 1 through 16 in accordance with specific instructions.

(b) *Determining taxable income and tax of fiduciary.*—If the amount shown on line 16 is not more than the amount of income required to be distributed currently (less the tax-exempt income reduced by the allocable expense) enter on line 17 the amount shown on line 16 and enter zero on line 23. Lines 24 through 40 need not be completed.

If the amount shown on line 16 exceeds the amount of income required to be distributed currently less nontaxable income, enter on line 17 the amount of income required to be distributed currently (less the tax-exempt income reduced by the allocable expense) and complete the remainder of page 1.

Simple trust with capital gains (or losses)

The short-form method of completing the return may also be used for a simple trust with capital gains (or losses). However, the capital gains and losses must be reported in Schedule D (Form 1041), and the following additional instructions must be taken into account:

(i) If capital gains are allocable to corpus, enter on line 17 the amount of income other than capital gains required to be distributed currently.

(ii) If capital gains are allocable to income, enter on line 17 the amount of income including capital gains required to be distributed currently.

(iii) If line 6 shows a loss, such loss cannot be carried forward to Schedule E (Form 1041), or the fiduciary's acceptable substitute. Enter on line 17 the amount of income required to be distributed currently without reduction for capital losses.

(iv) If line 7 shows a loss, such loss must be treated as a deduction in computing income required to be distributed currently.

For treatment of capital gains dividends and undistributed capital gains of regulated investment companies, see Schedule D (Form 1041) Instructions.

Specific Instructions—Page 1 of return

The following instructions for this page are numbered to correspond with line numbers on return

Income

1. Dividends.—Enter the total (before dividend exclusion) of all taxable dividends.

So-called "dividends" or "earnings" from the following corporations are considered interest for Federal income tax purposes and must be reported as interest on line 2: mutual savings banks, cooperative banks, domestic building and loan associations, domestic savings and loan associations, and Federal savings and loan associations, on deposits or withdrawable accounts; and Federal credit unions.

For an estate which is a shareholder in a "small business corporation", see specific instruction 8.

Note.—An estate or trust may exclude up to $100 of certain dividend income. However, if all or part of such dividend income is distributed to beneficiaries, the deduction allowed to the fiduciary for distributions to beneficiaries will be reduced by that part of the exclusion that bears the same ratio thereto that the dividends distributed bears to the total dividends received by the estate or trust. This is accomplished in the return by allowing a net exclusion on line 18 which takes into account both the full exclusion and the adjustment to the deduction for distribution to beneficiaries. See specific instruction 18.

2. Interest.—Enter the total of all taxable interest. In addition to the interest described in specific instruction 1, this would include interest on Government obligations, except interest fully exempt from tax, interest on bank deposits, notes, corporate bonds, tax-free covenant bonds upon which a Federal income tax was paid at source, interest received on tax refunds, etc.

A taxpayer on the cash basis may elect, as to all non-interest-bearing obligations issued at a discount and redeemable at fixed amounts increasing at stated intervals (for example, United States savings bonds), to include the increase in redemption price applicable to the current year. For the year of election, the total increase in redemption price of such obligations occurring between the date of acquisition and the end of the year must be included. A taxpayer so electing must report such income as interest on line 2 and attach a statement listing the obligations owned and the computation of accrued income. An election exercised in the current year or in a prior year is binding for all subsequent years.

3. Income from partnerships and other fiduciaries.—The estate's or trust's share of income of the following classes from a partnership

(including a syndicate, pool, etc., not taxable as a corporation) and from another fiduciary must be entered on the appropriate lines:

Dividends,
and
Gains and losses from sale or exchange of capital assets and other property.

The share of all other income or allowable losses from partnerships and other fiduciaries must be entered on line 3.

4. Rents and royalties.—Enter the gross amount of rents and royalties received or accrued. Any deductions claimed for interest, taxes, depreciation or depletion, and repairs must be included on lines 10, 11, 12, and 14, respectively.

5. Profit (or loss) from trade or business.—If the estate or trust was engaged in a trade or business during the taxable year, attach a statement showing the nature of the trade or business, gross profit, deductions, and net income. Enter the gross profit from the business on line 5, and items of other income on other appropriate lines on page 1, according to the character of such income.

The total deductible expenses, other than depreciation, depletion, and charitable contributions must be included in the amount on line 14, page 1. See specific instructions for Schedules A and B for deductions for depreciation, depletion, and charitable contributions.

6 and 7. Sales and exchanges of property.—Gains and losses from the sale or exchange of property must be reported in Schedule D (Form 1041) and the amounts from lines 12 and 24 of Schedule D (Form 1041) carried to lines 6 and 7, respectively, on page 1 of Form 1041. See Schedule D (Form 1041) Instructions.

8. Other income.—Enter the total of all taxable income not reportable elsewhere on page 1, and show the nature of such income, attaching a separate sheet if necessary for that purpose.

Shareholders of "Small Business Corporations."—An estate which is a shareholder of a "small business corporation" which qualifies to have its undistributed taxable income taxed directly to its shareholders (rather than to the corporation) must report its share of both the distributed and undistributed taxable income of the corporation as ordinary income on line 8, page 1, of Form 1041, except that portion which is reportable as a long-term capital gain in Schedule D (Form 1041). Neither type of income is eligible for the dividend exclusion.

Deductions

10. Interest. — Enter deductible interest paid or accrued, other than on business indebtedness (which must be treated according to specific instruction 5). Do not include interest on indebtedness incurred or continued to purchase or carry obligations which yield interest exempt from tax. For disallowance of unpaid interest due related persons, see section 267.

11. Taxes. — Enter deductible taxes paid or accrued during the taxable year by the estate or trust. Some non-Federal taxes are deductible. Federal import duties, and Federal excise and stamp taxes are deductible only if paid or incurred in carrying on a trade or business or in the production or collection of income or in the management, conservation or maintenance of property held for the production of income. However, if they are deductible as a business expense, such taxes and other taxes on property used in the trade or business are to be treated in accordance with specific instruction 5. The following taxes are not deductible: (i) generally, taxes assessed against local benefits of a kind tending to increase the value of the property assessed; (ii) Federal income taxes; (iii) estate, inheritance, succession, or gift taxes, except as noted in the next paragraph relative to Federal estate taxes; (iv) taxes imposed upon the interest of an estate or trust as a shareholder of a corporation which are paid by the corporation without reimbursement from the estate or trust; and (v) any portion of income, war profits or excess profits taxes paid or accrued to a foreign country or United States possession if any credit is claimed on line 28, page 1.

Section 691 provides that a taxpayer required to include in gross income any amount in respect of a decedent may deduct that portion of the Federal estate tax on the decedent's estate which is attributable to the inclusion in the decedent's estate of the right to receive such amount. If an estate or trust receives income in respect of a decedent which is paid, credited, or required to be distributed to a beneficiary, see section 691(c) (1)(B).

12. Fiduciary's portion of depreciation and depletion.—See specific instructions for Schedule A.

13. Charitable deduction.—See specific instructions for Schedule B.

14. Other deductions.—Itemize all authorized deductions not deductible elsewhere on page 1, attaching a separate sheet if necessary. Examples of such deductions are:

Nontrade or nonbusiness expenses.—Include expenses incurred either (*a*) for the production or collection of taxable income, (*b*) for the management, conservation, or maintenance of property held for the production of taxable income, or (*c*) in connection with the determination, collection, or refund of any tax. Losses on worthless bonds and similar obligations, and nonbusiness bad debts must be included in Schedule D (Form 1041) as losses on capital assets.

Deductions which may be allowable for estate tax purposes.—*Note:* Funeral, medical and dental expenses are never deductible in determining the income tax of an estate.

Sections 2053 and 2054 (deductions for estate tax purposes) provide for the deduction from the gross estate of certain expenses and losses which are also deductible in computing the taxable income of the estate or trust. No such deductions are allowable in computing the taxable income of an estate or trust unless there is filed for association with the return in which the items are claimed as deductions, a statement in duplicate to the effect that the items have not been allowed as deductions from the gross estate of the decedent under the applicable Federal estate tax law and that all rights to have such items allowed at any time as deductions under the applicable Federal estate tax law are waived. Clearly identify any such items in the statement and waiver. This paragraph does not apply with respect to deductions allowed under section 691, relating to income in respect of a decedent.

Bond premium.—Section 171 provides for amortization of bond premium. In the case of taxable bonds the amortization of premium is elective. For estates and trusts the election may be made only by the fiduciary. On tax-exempt bonds such amortization is mandatory, but no deduction from income is allowable.

On taxable bonds acquired after December 31, 1957, the premium must be amortized to maturity or to the earliest call date, whichever results in the smaller amount of amortization for the period to the earliest call date. On taxable bonds acquired before January 1, 1958, but after January 22, 1954, if they were issued after January 22, 1951, and have a call date not more than 3 years after the date of issue, the premium must be amortized to maturity. On other bonds the premium may be amortized to maturity, or to the date on which first callable. Attach a statement showing computation of deduction.

The basis of tax-exempt bonds must be reduced by amortization of premium. In the case of taxable bonds, the basis must be reduced if an election has been made to amortize.

Nonbusiness casualty losses.—The amount of loss to be deducted is measured by the fair market value of the property just before the casualty less its fair market value immediately after the casualty (but not more than the cost or adjusted basis of the property), reduced by any insurance or compensation received and limited to the amount in excess of $100 for each loss.

Net operating loss deduction.—The net operating loss allowed by section 172 is subject to the exceptions and limitations contained in section 1.642(d)–1 of the regulations governing substantial owners and charitable and distribution deductions. Every taxpayer claiming a net operating loss deduction must file with the return a detailed statement showing the computation thereof.

Unallowable deductions.—No deductions are allowable (*a*) for expenses which are allocable to one or more classes of income (other than interest income) exempt from tax, or (*b*) for any amount relating to expenses for production of income which is allocable to interest income exempt from tax. For the treatment of interest expense attributable to tax-exempt income, see specific instruction 10. For the determination of the amount of expense attributable to tax-exempt income, see specific instructions for Schedule C.

For the disallowance of unpaid expenses due related persons see section 267.

17. Deduction for distributions to beneficiaries.—See general instruction R for the "short-form method" for simple trusts to complete their returns and specific instructions for Schedule C, Schedule E (Form 1041), or the fiduciary's acceptable substitute, must be filed with Form 1041 for each beneficiary.

18. Dividend exclusion. — Enter the lesser of (i) the first $100 (or less) of dividends received from domestic corporations during the taxable year, or (ii) the amount of (i) reduced by an amount which bears the same ratio thereto that the total dividends allocated to beneficiaries bears to the amount on line 1, page 1 of Form 1041. See section 116 and specific instruction 1. This exclusion does not apply to dividends received from: (*a*) China Trade Act corporations; (*b*) so-called exempt organizations (charitable, fraternal, etc.) and farmers' cooperative organizations; (*c*) regulated investment companies, except to the extent that such dividends are designated by the company as dividends for these purposes; (*d*) corporations to which section 931 (relating to income from sources within possessions of the United States) applies; or (*e*) real estate investment trusts.

19. Federal estate tax. — See general instruction K.

21. Deduction for exemption.—An estate is allowed a deduction of $600. A trust which, under its governing instrument, is required to distribute all of its income currently, is allowed a deduction of $300; all other trusts are allowed a deduction of $100.

Note.—If final distribution of assets has been made during the year, all income of the estate or trust must be entered as distributed to beneficiaries and no deduction is allowable for exemption.

24. Tax rate schedule. — The amount of the tax must be determined in accordance with the following rate schedule:

If line 23, page 1, is:			*Enter on line 24, page 1:*
Not over $500			14% of the amount on line 23
Over—	But not over—		of excess over—
$500	—$1,000	$70, plus 15%	—$500
$1,000	—$1,500	$145, plus 16%	—$1,000
$1,500	—$2,000	$225, plus 17%	—$1,500
$2,000	—$4,000	$310, plus 19%	—$2,000
$4,000	—$6,000	$690, plus 22%	—$4,000
$6,000	—$8,000	$1,130, plus 25%	—$6,000
$8,000	—$10,000	$1,630, plus 28%	—$8,000
$10,000	—$12,000	$2,190, plus 32%	—$10,000
$12,000	—$14,000	$2,830, plus 36%	—$12,000
$14,000	—$16,000	$3,550, plus 39%	—$14,000
$16,000	—$18,000	$4,330, plus 42%	—$16,000
$18,000	—$20,000	$5,170, plus 45%	—$18,000
$20,000	—$22,000	$6,070, plus 48%	—$20,000
$22,000	—$26,000	$7,030, plus 50%	—$22,000
$26,000	—$32,000	$9,030, plus 53%	—$26,000
$32,000	—$38,000	$12,210, plus 55%	—$32,000
$38,000	—$44,000	$15,510, plus 58%	—$38,000
$44,000	—$50,000	$18,990, plus 60%	—$44,000
$50,000	—$60,000	$22,590, plus 62%	—$50,000
$60,000	—$70,000	$28,790, plus 64%	—$60,000
$70,000	—$80,000	$35,190, plus 66%	—$70,900
$80,000	—$90,000	$41,790, plus 68%	—$80,000
$90,000	—$100,000	$48,590, plus 69%	—$90,000
$100,000		$55,490, plus 70%	—$100,000

26. Tax surcharge.—For calendar year 1968 returns, enter 7.5% of line 24 or line 25 whichever is applicable. For fiscal year 1968–69 returns, enter 10% of line 24 or line 25 whichever is applicable times the number of days in the taxable year after March 31, 1968, and before July 1, 1969, and divided by the number of days in the entire taxable year.

28. Foreign tax credit.—If credit is claimed under section 901 for income or profits taxes paid to a foreign country or to a possession of the United States, submit Form 1116 with the return. The allowable credit is equal to the total credit shown on Form 1116 minus the proportionate share of the credit allocable to the beneficiaries.

29. Investment credit.—An estate or trust is allowed a credit for its share of the investment in certain depreciable property having an estimated useful life of 4 years or more. The investment is apportioned between the estate or trust and the beneficiaries on the basis of the income allocable to each. To support the investment credit claimed by the estate or trust, attach Form 3468, Computation of Investment Credit,

to Form 1041. Only the portion of the investment allocable to the estate or trust should be shown on Form 3468. See the instructions on the reverse of Form 3468 for the limitation and other information on the credit. If distributions are made to the beneficiaries, attach a schedule showing: (a) each beneficiary's allocable share of the basis of new property and the "life years" assigned to the property including investment in suspension period property; and (b) each beneficiary's allocable share of the cost of used property and the "life years" assigned to the used property including investment in suspension period property.

32. Tax from recomputing fiduciary's share of prior year investment credit.—Where property is disposed of prior to the life used in computing the investment credit, the tax for the year in which the property is so disposed of must be increased by the difference between the credit taken on such property and the credit which would have been allowed had the actual life been used. If the investment of a prior year was apportioned between the estate or trust and the beneficiaries, such increase must be similarly apportioned.

35. Credit for nonhighway Federal gasoline tax and lubricating oil.—If credit is claimed under section 39 of the Code for Federal tax paid on gasoline or lubricating oil used for nonhighway or other purposes described therein, attach Form 4136 to substantiate the credit. To obtain this credit your return must be timely filed (including any extensions).

36. Credit from regulated investment companies.—If credit from regulated investment companies is claimed, see Schedule D (Form 1041) Instructions and attach copy B of Form 2439.

37. Tax previously paid or withheld.—Enter such items as tax paid on a tentative return and withholding taxes on wages and salaries of a decedent which are received by the fiduciary. Attach an explanation to the return.

Page 2 of return

Schedule A. — Depreciation. — This schedule relates to the deduction for depreciation under section 167. Also see Revenue Procedure 62–21 (supplemented by Revenue Procedure 65–13) for alternative guideline lives and administrative procedures. If a deduction for depletion is claimed (see sections 611 through 614), attach a statement to show the details.

Beneficiaries' and fiduciary's shares of depreciation and depletion deductions.—An estate or trust is allowed the deductions for depreciation and depletion only to the extent that these deductions are not allocable to beneficiaries.

In the case of a trust, the allowable deductions are to be apportioned between the income beneficiaries and the trustee on the basis of the trust income allocable to each, unless the governing instrument (or local law) requires or permits the trustee to maintain a reserve in any amount. If so, the deduction is first allocated to the trustee to the extent that income is set aside for a reserve, and any part of the deduction in excess of the income set aside for the reserve is apportioned between the income beneficiaries and the trustee on the basis of the trust income (in excess of the income set aside for the reserve) allocable to each. In the case of an estate, the allowable deductions for depreciation and depletion are apportioned between the estate and the heirs, legatees, or devisees on the basis of the income of the estate allocable to each.

Enter on line 5 of Schedule E (Form 1041), or the fiduciary's acceptable substitute, the beneficiary's share of depreciation plus depletion shown in the attached statement. Enter on line 12, page 1, Form 1041, fiduciary's share of deprecation shown on line 5 of Schedule A plus his share of depletion shown in the attached statement.

Additional first-year depreciation allowance for estates.—An estate may elect to write off 20 percent of the cost (before adjustment for salvage value) of tangible personal property with a useful life of 6 years or more; up to an aggregate cost of $10,000. Total additional first-year depreciation must be shown on line 1 of the depreciation schedule. The maximum allowance available to an estate is $2,000 reduced by any part of the allowance distributed to any beneficiary. A beneficiary does not take into account the amount of any allowance distributed to him by an estate in determining his personal $10,000 or $20,000 limitation.

Schedule B.—Charitable deduction.—An estate or trust is allowed a deduction for any amount of gross income which pursuant to the terms of the governing instrument is, during the taxable year, paid or permanently set aside for a purpose specified in section 170(c), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance or operation of a public cemetery not operated for profit. This deduction is not subject to the percentage limitation imposed by section 170 on the charitable deduction of an individual, but is subject to the limitations described below. For further special limitations in the case of improper accumulations, prohibited transactions, etc., see section 681(b) and (c). A trust claiming a charitable, etc., deduction under section 642 (c) for the taxable year must file the information return required by section 6034 on Form 1041A which may be obtained from the District Director of Internal Revenue.

Contributions attributable to current income.—Enter on line 1, Schedule B, the full amount paid or permanently set aside for the purposes described above out of the current year's income. This does not include capital gains allocable to corpus, but does include capital gains which are treated as income under the governing instrument and local law. Capital gains which are allocable to corpus must be entered on line 7.

Line 2 provides for an adjustment of the charitable contributions attributable to income of the current year (line 1), so that the charitable deduction will not include contributions attributable to tax-exempt interest. In the absence of specific provisions in the governing instrument, enter on line 2 the result obtained by multiplying line 1 by the total of all tax-exempt interest included in income of the current year (under the governing instrument and local law) and dividing by the total of all income items included in income of the current year (under the governing instrument and local law). In computing the total of all items of income under applicable local law, do not reduce income by any losses (such as losses from the sale or exchange of property).

Lines 3 and 4 provide for adjustment of a charitable contribution which includes long-term capital gains allocable to trust income in order to prevent a double deduction under section 1202 for such gains. Enter on line 3(a) the total amount of long-term gain contained in the amount on line 1. This is computed by multiplying the amount shown on line 1 by the total of long-term capital gains allocated to income (under the governing instrument and local law) and dividing the result by the total of all the income items included in income of the current year (under the governing instrument and local law). For purposes of this adjustment, long-term capital gain of the current year allocable to corpus and paid or permanently set aside for a charitable purpose is not included in the contribution to charity out of the current year's income. Such amounts are included on line 7, after a similar adjustment is made.

Contributions not attributable to current income.—Enter on line 7 the total of all net short-term capital gains and 50% of all net long-term capital gains of the taxable year not included on line 1 and which are paid or permanently set aside for the purposes specified in section 170(c) (definitions of charitable contributions) or to be used for the charitable, etc., purposes specified in section 642(c). Enter on line 8 the total of *deductible* amounts paid or permanently set aside for the purpose specified in section 170(c) or to be used for the charitable, etc., purposes specified in section 642(c) to the extent that such amounts are not attributable to income (under the governing instrument and local law) of the current year or capital gains included on line 7. Attach a statement to show the details.

Schedule C.—Distributable net income and distributions deduction.—This schedule provides for the computation of the deduction allowable to the fiduciary for amounts paid, credited, or required to be distributed to the beneficiaries of the estate or trust. The deduction is equal to the amounts paid, credited, or required to be distributed or the distributable net income, whichever is smaller, adjusted in either case so as to exclude items of tax-exempt income entering into distributable net income. Distributable net income is an amount which limits the amount deductible by the estate or trust for distributions and (except in the case of a current income beneficiary of an estate or trust which claims a charitable deduction) the amount taxable to the beneficiary. It is also used to determine the character of the distributions to the beneficiaries.

For the purpose of determining distributable net income in the case of a complex trust, if the shares of different beneficiaries are substantially separate and independent, such shares must be treated under the separate share rule as separate trusts, under certain circumstances. See section 663(c) and the regulations thereunder. If the separate share rule is applicable, a separate Form 1041 (except for lines 17 through 40 on page 1) for each share must be attached to the return, as a supplemental schedule. This procedure is solely for the purpose of determining the deduction for distributions under section 661 and the amounts to be included in gross income of beneficiaries under section 662.

Line 2(a): Enter the amount of tax-exempt interest received, less: (i) the amount of tax-exempt interest shown on line 2 of Schedule B; and (ii) any amounts which, without the provisions of section 265, would be deductible in respect of disbursements, expenses, losses, etc., of the estate or trust, directly or indirectly allocable to such interest. The amount of the indirect disbursements, etc., allocable to tax-exempt interest is that amount which bears the same ratio to the total disbursements, etc., of the estate or trust not directly attributable to other items of income as the total tax-exempt interest received bears to the total of all the items of gross income (including tax-exempt interest) entering into distributable net income.

Line 6: Enter the amount of income of the estate or trust required to be distributed currently to all beneficiaries, whether distributed or not. For the purpose of determining what amounts are to be included on line 6, the question of what are items of income and the question of whether an amount is required to be distributed currently are to be determined under the governing instrument and the applicable local law. If the governing instrument requires that stated amounts be paid to a beneficiary and further provides that such amounts may be paid either out of income or out of corpus, such amounts are to be included on line 6 to the extent they are actually paid out of income of the current year.

Line 7: Except as noted in the two following paragraphs, enter on line 7 other amounts actually paid, credited, or required to be distributed to beneficiaries in the taxable year, whether from income (current or accumulated) or from corpus. Do not include on either line 6 or 7 any amounts deducted in a prior year return which were credited or required to be distributed in such prior year.

Amounts not included.—Do not include on either line 6 or 7 any amount which, under the terms of the governing instrument, is properly paid or credited as a gift or bequest of a specific sum of money or of specific property. To qualify as a gift or bequest excluded from lines 6 and 7, a sum must be paid all at once or in not more than three installments. Furthermore, an amount which can be paid or credited only from the income of the estate or trust is not considered a gift or bequest of a specific sum of money. See section 663(a)(1). Do not include on either line 6 or 7 any amount paid or permanently set aside for the purposes described in section 642(c) or otherwise qualifying for the charitable deduction. See section 663(a)(2).

Elective 65-day rule.—The fiduciaries of certain trusts created before January 1, 1954, who have elected to treat distributions within [illegible] first

65 days of the taxable year of the trust as amounts which were paid or credited on the last day of the preceding taxable year must continue such treatment. See section 663(b).

Line 9: Enter the amount of tax-exempt income included in lines 6 and 7 less the amount of tax-exempt income included in any charitable deduction and less the allocable share of expenses not otherwise allowable on page 1. The allocable share is that portion of expenses not directly allocable to any income as the ratio of tax-exempt income bears to total income.

Separate schedules

Schedule D.—Gains and losses from sales or exchanges of property.—Separate Schedule D (Form 1041) must be filed with Form 1041 to report gains and losses from the sale or exchange of property.

Schedule E.—Beneficiary's share of income, deductions, and credits.—Copy A of separate Schedule E (Form 1041), or the fiduciary's acceptable substitute, must be filed with Form 1041 for each beneficiary.

Schedule J.—Allocation of accumulation distribution.—Separate Schedule J (Form 1041) must be filed with Form 1041 for a complex trust to report an accumulation distribution as defined in section 665 (b) of the Code.

Reconciliation Worksheet.—The worksheet below may be used in the ordinary case to determine if the income reported on all separate Schedules E (Form 1041) is the same amount as the distributions deduction on line 17, page 1, Form 1041. In some cases (certain charitable deductions for example) the amounts may not be the same due to special computations which may be necessary.

If you wish to use the worksheet, add the amounts on line 1 of each separate Schedule E (Form 1041) and enter the total on line 1(a) of the worksheet. Repeat this process for each of the other income lines on Schedule E (Form 1041). Finally, complete the worksheet by adding lines 1(a) through 1(d), and by entering on line 2 the amount of the distributions deduction from line 17, page 1, Form 1041. The amount on line 1(e) of the worksheet should be the same as the amount on line 2.

The worksheet is for optional use and is NOT required to be filed with the return.

Reconciliation Worksheet

1. Total income reported on all separate Schedules E (Form 1041):	
(a) Dividends qualifying for exclusion	
(b) Short-term capital gain	
(c) Long-term capital gain	
(d) Other taxable income	
(e) Total (Lines a through d)	
2. Distributions deduction (Line 17, page 1, Form 1041) (Line 1(e) should equal line 2.)	

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FORM **1041**
U.S. Treasury Department
Internal Revenue Service

U.S. Fiduciary Income Tax Return

for the year January 1–December 31, 1968, or other taxable year
beginning _____, 1968, ending _____, 19__

1968

PLEASE PRINT OR TYPE

Check whether:
☐ Estate
☐ Simple trust
☐ Complex trust

If trust, check whether:
☐ Testamentary
☐ Inter vivos

Name of estate or trust | Employer identification Number

Name and title of fiduciary

Address of fiduciary (number and street)

City, State, and ZIP code

Simple trusts are not required to fill in Schedules B and C.

INCOME	1 Dividends (Enter full amount before exclusion)	60,000	
	2 Interest		
	3 Income from partnerships and other fiduciaries		
	4 Gross rents and royalties		
	5 Gross profit (loss) from trade or business		
	6 Net gain (loss) from capital assets (line 12, column 3, Schedule D, Form 1041)	40,000	
	7 Net gain (loss) from property other than capital assets (line 24, Schedule D, Form 1041)		
	8 Other income (State nature of income)		
	9 Total income (lines 1 to 8, inclusive)		100,000
DEDUCTIONS	10 Interest		
	11 Taxes		
	12 Fiduciary's portion of depreciation (Schedule A) and depletion. Explain depletion		
	13 Charitable deduction (line 9, Schedule B)	20,000	
	14 Other deductions (Itemize)		
	15 Total (lines 10 to 14, inclusive)		20,000
	16 Line 9 minus line 15 (Complex trusts and estates enter this amount on line 1 in Schedule C also)		80,000
	17 Deduction for distributions to beneficiaries	60,000	
	18 Adjustment of dividend exclusion		
	19 Federal estate tax attributable to income in respect of a decedent (Fiduciary's share)		
	20 Long-term capital gain deduction. Enter 50% of line 13(e), Schedule D, Form 1041	20,000	
	21 Exemption		
	22 Total (lines 17 to 21, inclusive)		80,000
	23 Taxable income of fiduciary (line 16 minus line 22)		0
COMPUTATION OF TAX	24 Tax on amount on line 23 (See tax rate schedule)		
	25 If alternative tax is applicable, enter the tax from line 22, Schedule D, Form 1041		
	26 Tax surcharge (See instruction 26)		
	27 Total (line 24 or line 25, whichever is applicable, and line 26)		
	28 Fiduciary's share of foreign tax credit (Attach Form 1116)		
	29 Fiduciary's share of investment credit (Attach Form 3468)		
	30 Total (lines 28 and 29)		
	31 Balance (line 27 less line 30)		
	32 Tax from recomputing fiduciary's share of prior year investment credit (Attach statement)		
	33 Total (lines 31 and 32)		
	34 Fiduciary's share of credit for tax paid at source on tax-free covenant bond interest		
	35 Credit for nonhighway Federal gasoline tax and lubricating oil (Attach Form 4136)		
	36 Credit for regulated investment companies (Attach Form 2439)		
	37 Tax previously paid or withheld (Attach explanation)		
	38 Total (lines 34 to 37, inclusive)		
	39 Balance of tax due (line 33 less line 38)		
	40 Overpayment (line 38 less line 33)		

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief it is true, correct, and complete. If prepared by a person other than taxpayer, his declaration is based on all information of which he has any knowledge.

Sign here ▶ _____ Signature of fiduciary or officer representing fiduciary — Date

▶ _____ Signature of preparer other than fiduciary — Address — Date

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EXHIBIT B

Schedule A.—DEPRECIATION—Taxpayers using Revenue Procedures 62-21 and 65-13: Make no entry in column 2, enter the cost or other basis of assets held at end of year in column 3, and enter the accumulated depreciation at end of year in column 4.

1. Group and guideline class or description of property	2. Date acquired	3. Cost or other basis	4. Depreciation allowed or allowable in prior years	5. Method of computing depreciation	6. Life or rate	7. Depreciation for this year
1 Total additional first-year depreciation—estates only (do not include in items below) →						
2 Totals						
3 Less amount of depreciation claimed elsewhere on return						
4 Balance (line 2 less line 3)						
5 Fiduciary's portion of line 4. Enter here and on line 12, page 1						

Schedule B.—CHARITABLE DEDUCTION—(Attach statement giving name and address of charitable organization.)

1 Amounts paid or permanently set aside for charitable purposes from current year's income		
2 Tax-exempt interest allocable to charitable distribution		
(Complete lines 3 and 4 below only if gain on line 11, column 2, Schedule D, Form 1041, exceeds loss on line 10, column 2, Schedule D, Form 1041)		
3 (a) Long-term capital gain included on line 1 (Do not complete lines (b) and (c) if such amounts are greater than line (a))		
(b) Enter gain on line 11, column 2, Schedule D, Form 1041, minus loss on line 10, column 2, Schedule D, Form 1041		
(c) Enter gain on line 11, column 3, Schedule D, Form 1041, minus loss on line 10, column 3, Schedule D, Form 1041		
4 Enter 50% of the smallest of line 3(a), line 3(b), or line 3(c)		
5 Enter sum of line 2 and line 4		
6 Balance (line 1 minus line 5)		
7 Enter short-term capital gains and 50% of the long-term capital gains of the current taxable year allocable to corpus, paid or permanently set aside for charitable purposes		20,000
8 Amounts paid or permanently set aside for charitable purposes other than from income of the current year		
9 Total (line 6 plus lines 7 and 8). Enter here and on line 13, page 1		20,000

Schedule C.—DISTRIBUTABLE NET INCOME AND DISTRIBUTIONS DEDUCTION

1 Enter amount from line 16, page 1	80,000
2 Add: (a) Tax-exempt interest (as adjusted)	
(b) Net gain shown on line 12, column 1, Schedule D, Form 1041. If net loss, enter zero	
(c) Lines 4 and 7, Schedule B	20,000
(d) Short-term capital gain included on line 1, Schedule B	
(e) If amount on line 6, page 1, is a loss, enter amount here	
3 Total (line 1 through line 2(e))	100,000
4 If amount on line 6, page 1, is a gain, enter amount here	40,000
5 Distributable net income (line 3 minus line 4)	60,000
6 Amount of income required to be distributed currently	60,000*
7 Other amounts paid, credited, or otherwise required to be distributed	
8 Total (lines 6 and 7)	60,000
9 Enter the total of tax-exempt income included on lines 6 and 7	
10 Balance (line 8 minus line 9)	60,000
11 Enter distributable net income (line 5, above)	60,000
12 Enter the amount from line 2(a), above	
13 Balance (line 11 minus line 12)	60,000
14 Distributions deduction. Enter here and on line 17, page 1, the lesser of line 10 or line 13 above	60,000

1 Date trust was created or, if an estate, date of decedent's death.

2 If return is for an estate, has a United States Estate Tax Return been filed? ☐ Yes ☐ No. If "No," will return be filed? ☐ Yes ☐ No ☐ Uncertain.

3 If you had tax-exempt income, have you deducted only that portion of expenses allocable to taxable income? ☐ Yes ☐ No.

4 Has final distribution of assets been made during the year? ☐ Yes ☐ No.

5 If the estate or trust received income from a nominee, state name, employer identification number, and address of nominee.

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*To be shown either on line 6 or on line 7, depending upon whether income is required to be distributed currently.

SCHEDULE D (Form 1041) U.S. Treasury Department Internal Revenue Service — Gains and Losses From Sales or Exchanges of Property — 1968

Name of estate or trust

Part I—CAPITAL ASSETS—Short-Term Capital Gains and Losses—Assets Held Not More Than 6 Months

a. Kind of property (if necessary, attach statement of descriptive details not shown below)	b. Date acquired (mo., day, yr.)	c. Date sold (mo., day, yr.)	d. Gross sales price	e. Depreciation allowed (or allowable) since acquisition	f. Cost or other basis, cost of subsequent improvements (if not purchased, attach explanation) and expense of sale	g. Gain or loss (d plus e less f)
1						
2 Enter your share of net short-term gain (or loss) from partnerships and other fiduciaries						
3 Enter unused short-term capital loss carryover from preceding taxable years (attach statement)						
4 Net short-term gain (or loss) from lines 1, 2, and 3. Enter here and on line 10 below						
Long-Term Capital Gains and Losses—Assets Held More Than 6 Months						
5						40,000
6 Enter the full amount of your share of net long-term gain (or loss) from partnerships, other fiduciaries, etc.						
7 Enter unused long-term capital loss carryover from preceding taxable years (attach statement)						
8 Capital gain dividends						
9 Net long-term gain (or loss) from lines 5, 6, 7, and 8. Enter here and on line 11 below						40,000

CAPITAL GAINS AND LOSSES

	1. Beneficiaries	2. Fiduciary	3. Total
10 Net short-term gain or loss from line 4, above			
11 Net long-term gain or loss from line 9, above		40,000	40,000
12 Total net gain or loss		40,000	40,000

Enter on line 6, page 1, Form 1041, the net gain shown on line 12, column 3, above. If net loss on line 12, column 3, above, enter as loss on line 6, page 1, Form 1041, whichever of the following is the smallest amount: (i) the amount of the loss, (ii) taxable income computed without regard to capital gains and losses and the deduction for exemption, or (iii) $1,000.

COMPUTATION OF FIDUCIARY'S CAPITAL GAINS DEDUCTION

13(a) Long-term capital gain shown on line 11, column 3, above	40,000
(b) Short-term capital loss shown on line 10, column 3, above	
(c) Excess of line 13(a) over line 13(b), above	40,000
(d) Long-term capital gains taxable to beneficiaries	
(e) Balance (line 13(c) minus line 13(d)). (Enter 50% of this amount on line 20, page 1, Form 1041.)	40,000

Part II—GAIN FROM DISPOSITION OF DEPRECIABLE PROPERTY UNDER SECTIONS 1245 AND 1250—Assets Held More Than 6 Months—Where double headings appear, use the first heading for section 1245 and the second heading for section 1250.

a. Kind of property (if necessary, attach statement of descriptive details not shown below—write 1245 or 1250 to indicate type of asset)	b. Date acquired (mo., day, yr.)	c. Date sold (mo., day, yr.)	d. Gross sales price	e. Cost or other basis, cost of subsequent improvements (if not purchased, attach explanation) and expense of sale
14				

f. Depreciation allowed (or allowable) since acquisition: f-1, Prior to January 1, 1962 — OR — Prior to January 1, 1964	f. Depreciation allowed (or allowable) since acquisition: f-2, After December 31, 1961 — OR — After December 31, 1963	g. Adjusted basis (e less sum of f-1 and f-2)	h. Total gain (d less g)	i. Ordinary gain (lesser of f-2 or h) — OR — (see instructions)	j. Other gain (h less i)
15 Total ordinary gain. Enter here and in column g, line 23, Part III					
16 Total other gain. Enter here and in column g, line 5, Part I; however, if the gains do not exceed the losses when this amount is combined with other gains and losses from section 1231 property, enter the total of column j in column g, line 23, Part III					

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COMPUTATION OF ALTERNATIVE TAX

If fiduciary had a net long-term capital gain or an excess of net long-term capital gain over net short-term capital loss shown in column 2, line 12, and line 23, page 1, Form 1041, exceeds $26,000, it may be to his advantage to make the alternative tax computation.

17 Amount from line 23, page 1, Form 1041	
18 50% of amount on line 13(e)	
19 Balance (line 17 minus line 18)	
20 Tax on amount on line 19 (see tax rate schedule)	
21 50% of amount on line 18, above	
22 Alternative tax (line 20 plus line 21); if less than line 24, page 1, Form 1041, enter this amount on line 25, page 1, Form 1041	

Part III—PROPERTY OTHER THAN CAPITAL ASSETS

a. Kind of property (If necessary, attach statement of descriptive details not shown below)	b. Date acquired (mo., day, yr.)	c. Date sold (mo., day, yr.)	d. Gross sales price	e. Depreciation allowed (or allowable) since acquisition	f. Cost or other basis, cost of subsequent improvements (if not purchased, attach explanation) and expense of sale	g. Gain or loss (d plus e less f)
23						
24 Net gain (or loss). Enter here and on line 7, page 1, Form 1041						

INSTRUCTIONS
(References are to the Internal Revenue Code)

Gains and losses from sales and exchanges of capital assets and other property.—In computing gross income no distinction is made between gains and losses allocable to income account and those allocable to corpus account.

"Capital assets" defined.—The term "capital assets" means property held by the estate or trust (whether or not connected with the trade or business) but does NOT include—

(*a*) stock in trade or other property of a kind properly includible in inventory if on hand at the close of the taxable year;

(*b*) property held by the taxpayer primarily for sale to customers in the ordinary course of trade or business;

(*c*) property used in the trade or business of a character which is subject to the allowance for depreciation provided in section 167;

(*d*) real property used in the trade or business of the taxpayer;

(*e*) certain government obligations issued on or after March 1, 1941, at a discount, payable without interest and maturing at a fixed date not exceeding one year from date of issue;

(*f*) certain copyrights, literary, musical, or artistic compositions, etc.; or

(*g*) accounts and notes receivable acquired in the ordinary course of trade or business for services rendered or from the sale of property referred to in (*a*) or (*b*) above.

Gains and losses from transactions described in section 1231 (see below) shall be treated as gains and losses from the sale or exchange of capital assets held for more than 6 months if the total of these gains exceeds the total of these losses. If the total of these gains does not exceed the total of these losses, such gains and losses shall not be treated as gains and losses from the sale or exchange of capital assets. Thus, in the event of a net gain, all these transactions should be entered in the "long-term capital gains and losses" portion of Schedule D. In the event of a net loss, all these transactions should be entered in the "property other than capital assets" portion of Schedule D, or in other applicable schedules on Form 1041.

Section 1231 deals with gains and losses arising from—

(*a*) sale, exchange, or involuntary conversion, of land (including in certain cases unharvested crops sold with the land) and depreciable property if they are used in the trade or business and held for more than 6 months,

(*b*) sale, exchange, or involuntary conversion of livestock (but not including poultry) held for draft, breeding, or dairy purposes and held for 1 year or more,

(*c*) the cutting of timber or the disposal of timber, coal, or domestic iron ore to which section 631 applies, and

(*d*) the involuntary conversion of capital assets held more than 6 months.

See sections 1231 and 631 for specific conditions applicable.

Gain from disposition of depreciable property under sections 1245 and 1250—Assets held more than 6 months (Part II).—(Report any gain from such property held for 6 months or less in Part III.) Except as provided below, section 1245 property means depreciable (*a*) personal property (other than livestock) including intangible personal property; and (*b*) tangible real property (except for buildings and their structural components) if used as an integral part of manufacturing, production, or extraction, or of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services, or used as a research or storage facility in connection with these activities; and (c) elevators and escalators.

Except as provided below, section 1250 property means depreciable real property (other than section 1245 property).

See sections 1245 (b) and 1250 (d) for exceptions and limitations involving: (*a*) disposition by gift; (*b*) transfers at death; (*c*) certain tax-free transactions; (*d*) like kind exchanges, involuntary conversions; (*e*) sales or exchanges to effectuate FCC policies and exchanges to comply with S.E.C. orders; (*f*) property distributed by a partnership to a partner; and (*g*) disposition of principal residence (section 1250 only).

Column f of Part II.—In computing depreciation allowed or allowable for elevators or escalators, enter in column f–1 depreciation prior to July 1, 1963, and in column f–2 depreciation after June 30, 1963.

Column i of Part II, section 1250 property only.—If held for more than 6 months, but not more than 1 year, enter the smaller of (1) column h, or (2) column f–2. If held for more than 1 year, enter the result of multiplying the smaller of (1) column h, or (2) column f–2 less the amount of depreciation computed for the same period using the straight line method, by the percentage obtained by subtracting from 100%, one percentage point for each full month the property was held in excess of 20 months. Where substantial improvements have been made within the preceding 10 years, see section 1250 (f).

(Instructions continued on reverse of duplicate)

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Service of the within and receipt of a copy thereof is hereby admitted this ..... day of August, A.D. 1978.

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